82-1766

No. 82-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

JOINT PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Harvey L. Pitt
(Counsel of Record)
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS, SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A. G. Becker Incorporated

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner Securities Industry Association

[Counsel continued on inside cover]

Of Counsel:

Steven M. Looney
General Counsel
A. G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

QUESTIONS PRESENTED

At issue is an unprecedented administrative construction of the Glass-Steagall Act, the primary federal statute governing the basic structure of the financial services industry in this country. This remedial statute, enacted as a result of the national banking crisis fifty years ago, prohibits banks flatly and entirely from underwriting any corporate "notes or other securities." The specific questions presented are:

1. Did the majority below err in holding that the Federal Reserve Board is free to "adapt" on a "case-by-case" basis the flat prohibition of the Glass-Steagall Act against bank underwriting of corporate notes, when Congress itself has repeatedly refused to grant any exemptive authority over the Act's flat prohibition to any administrative agency?

2. Did the majority below err in acceding to a ruling of the Federal Reserve Board that allows banks to underwrite short-term corporate notes, when even the Board concedes that such notes are within the plain language of the Glass-Steagall Act and this Court repeatedly has instructed that the statutory language is to be construed broadly and applied literally?

PARTIES TO THE PROCEEDING

In addition to the petitioners* and respondents listed in the caption, the following are also respondents in these consolidated actions: Paul A. Volcker as Chairman of the Board of Governors of the Federal Reserve System, Frederick H. Schultz, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmet J. Rice and Lyle E. Gramley as Members of the Board of Governors of the Federal Reserve System.

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* Pursuant to Rule 28.1 of this Court, petitioners state as follows: The Securities Industry Association is a national trade association representing more than 540 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States. The parent of petitioner A. G. Becker Incorporated is A. G. Becker Paribas Group Incorporated.

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Petitioners, the Securities Industry Association ("SIA") and A. G. Becker Incorporated ("A. G. Becker"), respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit (Tamm and Wilkey, J.J.; Robb, J. dissenting), entered in these consolidated proceedings on November 2, 1982.

OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit (1a)[1] is reported at 693 F.2d 136. The decisions of the Court of Appeals for the District of Columbia Circuit denying, by a split vote, a joint petition for rehearing (95a) and suggestion for rehearing *en banc* (97a) are unreported.

The opinion of the District Court for the District of Columbia granting summary judgment in favor of petitioners (39a) is reported at 519 F. Supp. 602. The administrative determination of the Board of Governors of the Federal Reserve System ("Board") in response to petitions by the SIA and A. G. Becker (65a) is unreported, and the Board's subsequent "Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks" (87a) is reported at 46 Fed. Reg. 29333 (June 1, 1981).

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on November 2, 1982. A timely petition for rehearing and suggestion for rehearing *en banc* was filed on December 17, 1982 and was denied by an order entered on February 2, 1983. The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

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1 Citations herein to material printed in the Appendix appear as "____a".

STATUTES INVOLVED

Involved in these actions are two sections of the Glass-Steagall Act.[2] Section 16 of the Act provides, in part:

> [A national bank] shall not underwrite any issue of securities or stock; . . . .

12 U.S.C. § 24 (Seventh) (Supp. 1982). Section 21 of the Act provides, in part:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1).

STATEMENT OF THE CASE

A. The Administrative Proceedings

In 1978 Bankers Trust Company, a commercial bank, initiated an aggressive campaign to convince existing and prospective corporate customers to distribute their commercial paper

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2 What is generally known as the Glass-Steagall Act was enacted as part of the Banking Act of 1933, 48 Stat. 162, and is codified in various sections of Title 12 of the United States Code. Relevant to this action are sections 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh) and 378. The terms of section 16, which expressly apply to national banks, are also made applicable to state member banks of the Federal Reserve System, such as Bankers Trust Company, by 12 U.S.C. § 335.

(*i.e.*, unsecured short-term promissory notes) through the bank, rather than through securities dealers. Bankers Trust then began marketing third-party commercial paper notes to non-bank purchasers—the first time any bank had done so in the nearly 50 years since the Glass-Steagall Act was enacted.

The SIA, representing over 90 percent of the securities firms in the country, and A. G. Becker, a major dealer in commercial paper, separately petitioned the Board to declare that the bank's activity violated the Glass-Steagall Act and to order the bank to cease and desist from its third-party commercial paper activity. (41a.)

The Board denied the petitions. Although the Board recognized that the issues involved were primarily legal in nature, conceded that the statute expressly precludes banks from underwriting "notes," and admitted that commercial paper comprises short-term notes, the Board concluded that the statute should not be accorded a literal reading. (69a, 74a, 86a.) The Board instead adopted a "functional" analysis which, ignoring the bank's role in the distribution of these notes, concluded that their sale was the equivalent of a commercial loan and therefore was appropriate for any type of bank participation. (78a.)

The Board's ruling, however, also recognized the "potentially unsound" practices that might proliferate if banks generally were to begin dealing in commercial paper. The Board therefore issued "guidelines" to govern the sale of commercial paper by all state bank members of the Federal Reserve System. (87a.) The Board's action thereby not only permitted one bank to engage in these marketing activities, but in effect encouraged all member banks to do likewise. (7a, n.17.)[3]

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3 This unprecedented ruling by the Board had an immediate impact on the inter-related regulatory systems governing this nation's financial markets. Because of what was described as the "abrupt change" effected by the Board's action allowing banks "for the first time" to underwrite securities, the United States Federal Energy Regulatory Commission was required to issue a temporary blanket exemption

After the Board's ruling, the SIA and A. G. Becker commenced lawsuits under the Administrative Procedure Act, 5 U.S.C. §§ 701, *et seq.*, before the District Court for the District of Columbia, challenging the ruling as contrary to law.

B. The District Court Decision

On cross-motions for summary judgment, the District Court (Joyce Hens Green, J.) held that commercial paper, which by the Board's own admission constitutes notes, fits within the proscriptions of sections 16 and 21 of the Glass-Steagall Act, prohibiting banks from dealing in corporate "notes" and "securities". The District Court refused to accept the narrow statutory construction proposed by the Board, noting that "[t]he statute draws broad lines, leaving no room for administrative amendment." (59a.)

The District Court also rejected the Board's "functional" argument that, because of its relatively short maturity, the nature of its purchasers, as well as other non-bank related factors, commercial paper functioned more as a commercial loan than as a security. That analysis was fundamentally incorrect, the District Court declared, because it "ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account . . . or purchases for future sale to an outside party or arranges a transaction between purchaser and seller." (62a.)

Holding the Board's ruling to be contrary to law, the District Court concluded that the Board had improperly redrawn the Congressionally mandated boundary between commercial and investment banking (63a; footnote omitted):

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from certain provisions of the Federal Power Act, 16 U.S.C § 825ld(b). *See* Order in Docket No. EL 81-5-000, March 27, 1981, 46 Fed. Reg. 19980 (April 2, 1981). The Securities and Exchange Commission was required to respond similarly to the Board's ruling, pursuant to its responsibilities under the Public Utility Holding Company Act. *See* SEC, Public Utility Holding Co. Act Release No. 35-21967 (March 18, 1981), 46 Fed. Reg. 18535 (March 25, 1981).

The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.

C. The Court of Appeals Decision

In a split decision, the Court of Appeals reversed the District Court.

1. The Majority Opinion

The majority's principal reason for reversal was its view that, although the issue presented was purely legal in nature, the Board should be free to "adapt" the statute on a "case-by-case basis" according to the Board's view of "current business reality." (9a.) Despite the broad language of sections 16 and 21 of the Act, prohibiting banks from underwriting all corporate "notes" and "securities," and despite this Court's repeated direction that those terms are *not* to be construed narrowly, the majority concluded that a "narrower meaning" should be accorded the statutory terms. (16a.) In the majority's view, the terms include only "instruments for raising capital as part of the permanent financial structure of a corporation," while "implicitly permitting" banks to underwrite all other types of debt instruments. (17a.)

The majority also addressed the Board's "functional analysis." While recognizing that, in a traditional loan transaction, a bank *purchases* commercial paper, the majority held that the bank here "is simply on the other side of the transaction." (27a.) Thus viewing the role of the bank as immaterial, the majority focused instead on characteristics such as the financial soundness of commercial paper issuers, the sophistication of its purchasers and the relatively low risk nature and short maturity of commercial paper, to conclude that such notes do not give rise to the hazards at which the Glass-Steagall Act was directed. (25a-30a.)

The majority held that the terms "notes" and "securities" in the Act did not encompass "prime quality commercial paper,

of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public." (30a; footnote omitted.) Significantly, however, it conceded that other commercial paper "of smaller denominations, or issued to the general public" (31a) could well be a "note" or "security" under the Act. The majority's holding, in short, was based upon its conclusion that the Board is free to define what "securities" are covered by the Act based solely upon the Board's assessment of the hazards that banks might encounter in underwriting them.

2. The Dissent

Senior Circuit Judge Robb dissented from the majority's analysis, finding that "the majority's holding contravenes the fundamental policy of the Glass-Steagall Act." (31a.) Judge Robb rejected the functional analysis followed by the Board and adopted by the majority, noting, as had the District Court, that it ignores the bank's role, which is actually "[t]he critical distinction between commercial banking and investment banking." (32a.)

Judge Robb also rejected the majority's focus on factors such as low default rates and sophistication of investors, pointing out that by "[r]elying on these factors, a bank could transform 'transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.' " (33a.) Judge Robb observed that Congress flatly prohibited bank underwriting of corporate securities "without regard to the likely 'soundness' of the securities which a bank might sell." (36a.) As he stressed, the Act "has no provision permitting bank sales of securities which are 'prime quality' or 'very low-risk'." (34a.) Judge Robb also found that bank marketing of commercial paper gives rise to precisely the sort of potential abuses and hazards reviewed by this Court in *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971) ("*ICI*").

Finally, Judge Robb disagreed completely with the majority's attempt to "force a narrow meaning onto the terms of the

Act." (37a.) In his view, the terms used by Congress—"stocks," "bonds," "debentures," "notes" and "other securities"—are all-encompassing and were intended to be so.

REASONS FOR GRANTING THE WRIT

I.

THE DECISION OF THE COURT OF APPEALS RAISES IMPORTANT ISSUES OF NATIONAL SIGNIFICANCE

The majority opinion below permits *ad hoc* administrative determination of permissible bank securities activities, defeating the flat prohibition of the Glass-Steagall Act and inevitably expanding the caseload of the federal judiciary as review of these *ad hoc* rulings is continually sought. Action by this Court is thus essential to resolve determinative issues concerning both the scope of activities that are permitted to banks by federal law and the manner in which federal regulation of financial institutions is to be carried out in the future.

First. The decision below is of general applicability, affecting the scope of activities of all of this nation's depository institutions. As both the District Court and the Court of Appeals recognized, the Board's action under review will have much broader impact than merely allowing one bank to underwrite commercial paper. If upheld, it in effect permits *all* 14,000 banks in this country to do likewise, for the first time in half a century. (7a, n.17; 51a-52a, n.7.) At the end of 1982, more than $166 billion in commercial paper was outstanding in the United States. 69 Fed. Res. Bull. A26 (March 1983).

Second. This action raises fundamental questions concerning the authority of federal bank regulators to "adapt" the basic Congressional restrictions on bank activities to their own-desired ends. Although the majority viewed the Act as permitting the Board to "adapt" it on a "case-by-case basis", to accommodate the Board's view of "current business reality" (9a), there is nothing in the statute itself, its legislative history,

or the prior decisions of this Court to support such a novel proposition. Rather, sections 16 and 21 of the Act contain flat prohibitions that are to be applied strictly, and as they were written.[4]

Congress did consider proposals, both when it originally enacted and when it first amended the Act, to permit regulators to define acceptable underwriting activities of banks; but Congress rejected completely such a regulatory approach.[5] Indeed, in 1935, the Conference Committee deleted language passed by the Senate which would have amended the Act to permit "national banks under regulation by the Comptroller of the Currency, to underwrite and sell bonds, debentures and notes. . . ."[6]

As recently as 1980, Congress reaffirmed its opposition to permitting administrative adjustment of the Glass-Steagall prohibitions. In enacting the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. No. 96-221, 94 Stat.

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4 In marked contrast with section 32 of the Act, 12 U.S.C. § 78, which permits the Board to exempt certain arrangements from the Act's management interlock provisions, neither section 16 nor section 21 vests *any* exemptive authority whatsoever in the Board to permit bank underwriting of corporate securities. The absolute approach chosen by Congress in the Glass-Steagall Act is also underscored by comparison with other banking legislation, such as the Bank Holding Company Act, 12 U.S.C. § 1841, *et seq.*, in which Congress *did* vest regulatory power in the Board to authorize bank holding companies to engage in those activities the Board finds to be "so closely related to banking as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).

5 The Senate Banking Committee originally considered and rejected several proposals which would have permitted banks to continue to engage in the securities business under a system of federal regulation. *See, e.g.*, H. Willis and J. Chapman, *The Banking Situation*, 67-69 (1934).

6 *See* H. R. Conf. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935). *See also*, S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935); 79 Cong. Rec. 13706 (1935) (remarks of Rep. Steagall); 79 Cong. Rec. 11934-35 (1935) (remarks of Sen. LaFollette).

132 (1980), Congress extended to the Comptroller of the Currency authority to issue such rules as were needed to "carry out the responsibilities of the office," but specifically made clear that the Comptroller had *no* authority to issue regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act'." 12 U.S.C. § 93a. The majority below nevertheless acquiesced in the Board's unilateral assumption of precisely the sort of broad regulatory authority that Congress repeatedly has rejected.

The majority's decision is all the more significant because during several recent terms, including the present one, Congress has been considering major legislative proposals that would, if enacted, materially alter the existing regulatory framework governing financial institutions. In each of its last three terms Congress enacted major reforms to the federal banking laws[7] but, in each instance, Congress has determined not to modify the Glass-Steagall Act restrictions in the slightest.[8]

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7 *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

8 To the contrary, Congress has reaffirmed its support for the flat prohibitions contained in the Act, denying, as noted, any authority for the Comptroller of the Currency to issue regulations under the Act, 12 U.S.C. § 93a, and most recently refusing to extend to banks the limited authority to underwrite revenue bonds or to distribute shares of open-end mutual funds, activities prohibited by the Act. *Compare* S. 1720, 97th Cong., 1st Sess. (1981) (proposing authority for banks to underwrite revenue bonds and mutual funds) *with* P.L. No. 97-320, 96 Stat. 1469 (1982) (containing no such authority). *See also, Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 2d Sess. 6-10 (1982) (testimony of Hon. Donald T. Regan, Secretary of the Treasury).

As a result, under extreme pressure from the institutions they regulate, federal banking agencies have simply begun to dismantle the Glass-Steagall Act through administrative "interpretation." Within the past year, alone, banks have been permitted to commence, for the first time since the Glass-Steagall Act was adopted 50 years ago, a variety of securities activities previously understood to be barred to banks. For example:

— although this Court held in *ICI* that shares in bank-created and bank-operated collective investment funds constitute "securities" within the meaning of the Act, one banking agency recently ruled that shares in such funds do *not* constitute "securities";[9]

— despite the Act and *ICI*, one banking agency has recently held that banks may distribute securities through shell subsidiaries;[10] and

— the Act and *ICI* notwithstanding, three banking agencies have separately ruled that banks may enter into the public securities brokerage business, including in one instance investment advisory services, either directly or through subsidiaries.[11]

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9 *Decision of the Comptroller of the Currency on the Application by Citibank To Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts* (October 28, 1982).

10 *FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-member Banks*, 47 Fed. Reg. 38984 (September 3, 1982).

11 *BankAmerica Corp. (Schwab)*, 69 Fed. Res. Bull. 105 (1983); *Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary To Be Known as Security Pacific Discount Brokerage Services, Inc.* (August 26, 1982); *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, Perpetual American Federal Savings & Loan Association and California Savings & Loan Association* (May 6, 1982).

As expected, each of these administrative actions is now subject to court challenge.[12]

If permitted to stand, the majority opinion will encourage bank regulators to continue assuming policy decisions of enormous economic and legal significance that should properly be addressed only by Congress. Also, the majority opinion will inevitably promote constant litigation challenging these *ad hoc* efforts to explore and expand the boundaries of the Act, possibly leading to unwarranted lower court decisions. These results are likely to be avoided only if this Court acts to reaffirm the limited role of banking regulators in connection with the statute's flat prohibition against bank securities activities.

Third. The majority opinion raises fundamental questions concerning the judiciary's responsibility "to construe the language employed by Congress"[13] and to enforce the complete separation of commercial banking from investment banking that Congress intended the Act to achieve. The opinion accords undue deference to the regulator's interpretation of the Act, even though the issues involved are, as the Board conceded, purely legal in nature.[14] (69a, 86a.) As a consequence,

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12 *See Investment Co. Inst.* v. *Conover*, No. 83-0549 (D.D.C., filed Feb. 24, 1983); *Investment Co. Inst.* v. *United States*, No. 82-2532 (D.D.C., filed Sept. 8, 1982); *Securities Industry Ass'n* v. *Board of Governors*, No. 83-4019 (2d Cir., filed Feb. 3, 1983); *Securities Industry Ass'n* v. *Conover*, No. 82-2865 (D.D.C., filed Oct. 6, 1982); *Securities Industry Ass'n* v. *Federal Home Loan Bank Bd.*, No. 82-1920 (D.D.C., filed July 12, 1982).

13 *Zuber* v. *Allen*, 396 U.S. 168, 193 (1969). *See also*, *Espinoza* v. *Farah Mfg. Co.*, 414 U.S. 86, 93-5 (1973); *Barlow* v. *Collins*, 397 U.S. 159, 167 (1970).

14 The majority simply refused to adhere to the teaching of this Court that discussion of deference is "pointless" where an administrative agency sanctions an activity that violates plain statutory language and purposes. *Federal Election Comm'n* v. *Democratic Senatorial Cam-*

the majority decision, if not reversed, will signal to the lower courts and to the federal regulators, abdication of the judiciary's responsibility to prevent the piecemeal, administrative dismantling of this fundamental federal statute.

In short, given its far-reaching scope and effect, the majority opinion below warrants review by this Court.

II.

THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH CONTROLLING DECISIONS OF THIS COURT AND RAISES SUBSTANTIAL QUESTIONS OF FEDERAL LAW CONCERNING THE PERMISSIBLE ACTIVITIES OF ALL BANKS

Disregarding this Court's repeated admonition that the prohibitions of the Glass-Steagall Act are to be construed broadly and applied literally, the majority opinion below constricts the reach of the Act and endorses a regulatory approach that would encourage administrators to exempt a whole host of securities from the Act's prohibitions.

A. The Majority Opinion Permits Bank Underwriting Activities Prohibited By the Plain Language of the Glass-Steagall Act and By Applicable Decisions of This Court

The Glass-Steagall Act represented the Congressional reaction to the financial chaos of the late 1920's and the ensuing banking crisis of the early 1930's. As this Court has observed, the Act was a "drastic step" considered by Congress to be "a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *ICI*, 401 U.S. at 629, 639.

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paign Comm., 454 U.S. 27, 31 (1981) ("courts are the final authorities on issues of statutory construction"). *See also, American Ship Bldg. Co. v. N.L.R.B.*, 380 U.S. 300, 318 (1965) (resort to deference "cannot be allowed to slip into a judicial inertia in the unauthorized assumption by an agency of major policy decisions properly made by Congress").

The broad prohibitions of Section 21 of the Act preclude any entity engaged in underwriting "stocks, bonds, debentures, notes, or other securities" from simultaneously accepting deposits. (12 U.S.C. § 378.) In parallel fashion, section 16 of the Act prohibits banks from underwriting "any issue of securities or stock." (12 U.S.C. § 24 (Seventh).) To further the remedial objective of Congress, this Court has admonished, in *every* case which has considered the meaning of terms of the Glass-Steagall Act, that its prohibitions are not to be accorded a narrow or technical meaning.[15] Specifically, as to the term "securities," this Court has instructed:

> [T]here is nothing in the phrasing of either § 16 or § 21 that suggests a narrow reading of the word securities. To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

ICI, 401 U.S. at 635.

Unaffected by this Court's decisions and the Board's own admission that commercial paper falls within the plain language of the statute, (4a),[16] the majority gave the statutory

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15 *See Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 65 (1981); *ICI*, 401 U.S. at 635; *Board of Governors* v. *Agnew*, 329 U.S. 441, 446-47 (1947); *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935) (construing terms of the McFadden Act re-enacted as part of the Glass-Steagall Act).

16 That Congress intended the words "notes" and "securities" to mean what they say and to encompass commercial paper is confirmed by the fact that in enacting the Securities Act of 1933, 15 U.S.C. § 77a, *et seq.*, just three weeks before the Glass-Steagall Act, Congress specifically rejected an effort by Senator Glass to exclude "nine months commercial paper" from the definition of "security" in that Act, and instead defined the term "security" to include "any note". 15 U.S.C. § 77b(1). *See Hearings on S. 875 Before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). *See also*, Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79, *et seq.*, enacted one business day after initial amendments to the Glass-Steagall Act were passed, in which Congress prohibited certain regulated companies from purchasing any "security" but provided an exception for the acquisition of "commercial paper and other securities" as permitted through regulation. 15 U.S.C. § § 79b(a)(16), 79i(c)(3).

language a "narrower meaning," so as to forbid banks from marketing only "instruments for raising capital as part of the permanent financial structure of a corporation" and thus "implicitly" permitting banks to underwrite *all* other debt instruments. (16a-17a.)

This limitation on the Act's broad prohibitions, however, has no source in the statutory language.[17] That Congress understands how to limit expressly the banking laws to capital raising instruments when it wants to (*see, e.g.*, 12 U.S.C. § 321 ("capital notes")) underscores the advertence of its failure to do so here. Indeed, to accept the majority's construction of the Act would exclude from its prohibitions numerous other instruments Congress clearly intended its plain language to encompass, *e.g.*, short-term bonds and debentures.

Even the majority realized the far-ranging consequences of abandoning the plain statutory language. Its "capital raising instrument" test, on its face, excludes all short-term debt instruments and, hence, would exclude all commercial paper—a conclusion the Board itself was unwilling to endorse. As a result, the majority simply stated, again without identifying the statutory source of the limitation, that "another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a 'security' under the Glass-Steagall Act." (31a.)

The majority opinion thus confirms the wisdom of this Court's insistence that the Act be interpreted broadly and applied literally. To ignore the plain language of the Act is to transform its flat Congressional prohibition into a loose sieve and to spawn the sort of "now-you-see-it-now-you-don't" definition to which the majority resorted. In plain language, the Act flatly and unambiguously prohibits banks from underwriting all corporate "notes" and "securities," including those notes referred to as commercial paper.

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17 The majority decision ignores the basic principle that the language employed by Congress "*must ordinarily be regarded as conclusive.*" *American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 68 (1982) (emphasis added; citations omitted). *Accord*, *Aaron* v. *S.E.C.*, 446 U.S. 680 (1980); *Lewis* v. *United States*, 445 U.S. 55 (1980).

B. The Majority Opinion Permits Bank Underwriting Activities that Create the Potential Hazards This Court Has Found the Glass-Steagall Act Sought to Avoid

By embracing the Board's "functional" analysis of the statutory terms. the majority opinion not only violates the plain language of the Glass-Steagall Act, but also violates Congress' fundamental objective in enacting the statute.

The majority's analysis focuses upon the characteristics of the instruments involved, while incorrectly treating a bank's role in connection with the instruments as immaterial. In so doing, the majority dismisses the difference between a bank's purchasing of commercial paper and its selling commercial paper as the bank's simply being "on the other side of the transaction." (27a.)

The Act, however, was intended to eliminate the potential for abuses and the conflicts of interest that arise whenever banks subject themselves to the "promotional incentives" and "pecuniary stake" of investment banking. *ICI*, 401 U.S. at 634. As Judge Robb recognized in dissent, the bank's role "is determinative under the Act" because "[t]he critical distinction between commercial banking and investment banking is the bank's role in the transaction." (32a.) Accordingly, any "functional" analysis under the statute must consider the *bank's* role in order to measure that involvement against the purpose of the Act. *See* Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L. J. 102 (1981).

By ignoring the role of the bank, the majority's holding violates the fundamental intent of Congress. Here, the bank functions not as a lender, but simply as a marketer of securities—the bank will earn its fees based solely upon its promotional success. From the perspective of a bank, the commercial paper it markets is merely a vehicle for earning those fees. The majority below simply disregarded this Court's warning in *ICI* that:

> When a bank puts itself in competition with [securities dealers] the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking.

401 U.S. at 637.

The Board itself recognized this problem when it acknowledged in its ruling that: "[T]he sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking." (84a.) The Board issued guidelines relating to the sale of commercial paper notes by banks, but such action is not, and cannot be, a sufficient response. The Glass-Steagall Act was meant to eliminate, not merely to "minimize," the potential for abuse that is *inherent* in the combination of investment and commercial banking.[18]

Similarly misconstruing the Congressional purpose, the majority reasoned that there were no potential hazards, because the notes being sold are of high quality and are purchased by sophisticated investors. But Congress made no exception for "low risk" or "prime quality" securities; instead, it preempted any such administrative judgment by prohibiting bank underwriting of *all* corporate securities. Indeed, the majority's reasoning actually proves the reverse because, as Judge Robb put it, sophisticated purchasers are "likely to be among the bank's most important and influential clientele," so that loss of their good will would be particularly "detrimental to the bank's commercial operation." (35a-36a.)

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18 As Senator Bulkley put it during Congressional debates on the Glass-Steagall Act, in language previously relied upon by this Court (*ICI*, 401 U.S. at 634; footnote omitted):

> If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep the banks out of the investment security business.

The recent example of Penn Central's default on $82.5 million of commercial paper notes which, only three weeks earlier, had been marketed as "prime" quality and sold in large denominations to sophisticated purchasers—and therefore would have been permissible for bank underwriting under the Board's guidelines—dramatically confirms that no number of administrative "guidelines" can effectuate the Congressional purpose. The intent of Congress can only be carried out by prohibiting the activity entirely, which is precisely what the Glass-Steagall Act was designed to do. (*See* Judge Robb's dissent at 34a-38a.)

In short, the majority's own analysis of Congressional objectives simply confirms, as does its view of the statute's plain language, that:

> [T]he majority's holding contravenes the fundamental policy of the Glass-Steagall Act . . . [which is] to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions.

(31a; Robb, J. dissenting.)

CONCLUSION

For the foregoing reasons, the requested Writ of Certiorari should issue.

Dated: April 29, 1983

Respectfully submitted,

Harvey L. Pitt
(Counsel of Record)
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS, SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A. G. Becker Incorporated

Of Counsel:

Steven M. Looney
General Counsel
A. G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner Securities Industry Association

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

A.G. BECKER INCORPORATED,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

APPENDIX TO JOINT PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Harvey L. Pitt
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A.G. Becker Incorporated

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
1737 H Street, N.W.
Washington, D.C. 20006
(202) 331-7760
Attorneys for Petitioner Securities Industry Association

[Counsel continued on inside cover]

Of Counsel:

Steven M. Looney
General Counsel
A.G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

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Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-2070, 81-1493, 81-2058,
81-2096 and 80-2314

Argued 3 June 1982
Decided 2 Nov. 1982
As Amended Nov. 2, 1982

A.G. BECKER INCORPORATED,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

APPEARANCES:

Richard M. Ashton, Washington, D.C., with whom Michael Bradfield, Washington, D.C., was on the brief for Bd. of Governors of the Federal Reserve System, et al., appellants Nos. 81-2058 and 81-2070 and appellants/respondents in Nos. 80-2258, 80-2314, 81-1493 and 81-2096, James V. Mattingly, Jr., Washington, D.C., also entered an appearance for the Bd. of Governors of the Federal Reserve System, et al.

James B. Weidner, New York City, with whom John M. Liftin, Washington, D.C., was on the brief for Securities Industry Ass'n., petitioner in No. 80-2314 and appellee in No. 81-2058. Janet R. Zimmer, Washington, D.C., also entered an appearance for Securities Industry Ass'n.

Harvey L. Pitt, Washington, D.C., with whom Henry A. Hubschman and Andrea Newmark, Washington, D.C., were on the brief for A.G. Becker Inc., petitioner in No. 80-2258, appellants in Nos. 81-2096 and 81-1493 and appellee/respondent in No. 80-2070. James H. Schropp, Washington, D.C., also entered an appearance for A.G. Becker Incorporated.

Robert S. Rifkind, New York City, entered an appearance for New York Clearing House Ass'n, amicus curiae in Nos. 81-1493, 81-2258 and 81-2096.

Charles F.C. Ruff, U.S. Atty., Royce C. Lamberth, Kenneth M. Raisler, William H. Briggs, Jr., Asst. U.S. Attys., Washington, D.C., also entered an appearance for appellee/respondent in No. 81-1493.

John W. Barnum and W. Michael Tupman, Washington, D.C., entered appearances for Bankers Trust Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Leonard H. Becker, Steven A. Musher and Joseph McLaughlin, Washington, D.C., entered appearances for Goldman, Sachs and Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Paul Gorson and Russell Stevenson, Washington, D.C., entered appearances for Securities and Exchange Com'n, amicus curiae in Nos. 81-2096 and 81-2058.

Before TAMM and WILKEY, Circuit Judges and ROBB, Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge WILKEY.

Dissenting opinion filed by Senior Circuit Judge ROBB.

WILKEY, *Circuit Judge*:

This case calls upon us to decide whether the Federal Reserve Board acted lawfully in permitting the Bankers Trust Company, a state member bank of the Federal Reserve System,[1] to act as agent in the sale of commercial paper. After Bankers Trust began marketing commercial paper, A.G. Becker, Inc., a broker-dealer in securities, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers, requested the Board to declare Bankers Trust's activities illegal and to bring appropriate enforcement action. Becker and the SIA contended that Bankers Trust was in violation of sections 16 and 21 of the Glass-Steagall Act ("the Act"), which prohibit commercial banks, with certain exceptions, from buying, selling, or underwriting "securities."[2] The Federal Reserve Board determined, however, that the commercial paper marketed by Bankers Trust

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1 *See* 12 U.S.C. §§ 321-339 (1976 & Supp. IV 1980).

2 Section 16 of the Act provides in pertinent part:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 Seventh (Supp. IV 1980).

Section 21 provides that:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1)(1976).

was not a "security" within the meaning of the Act.[3] Becker and the SIA then brought suit in the district court, which held the Board's determination to be invalid.[4] The Board appealed, and we reverse.

I. FACTS

"Commercial paper" refers to prime quality, negotiable promissory notes bearing very short maturities—generally 30 to 90 days.[5] Large, financially strong corporations use commercial paper to obtain funds for current needs. Commercial paper is sold, in denominations averaging one million dollars or more, to large, sophisticated purchasers—money market mutual funds, bank trust departments, insurance companies and pension funds.[6]

Bankers Trust began placing third party commercial paper in 1978.[7] Its issuers had the highest rating from at least one of the rating services for commercial paper issuers; its customers were part of the bank's established base of institutional investors, who regularly purchase short term instruments from the bank. The bank offered to act as financial adviser to issuers of paper sold by the bank, and to extend credit to them, though for only

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3 Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (26 Sept. 1980), Joint Appendix (J.A.) at 220 [hereinafter cited as Federal Reserve Statement].

4 *A.G. Becker, Inc.* v. *Board of Governors*, 519 F. Supp. 602 (D.D.C. 1981).

5 *See generally* Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

6 *See* sources cited at *supra* note 5. *See also infra* p. 149 [26a].

7 This description of Bankers Trust's activities relies upon Federal Reserve Statement, *supra* note 3, at 2-3, J.A. at 221-22. Appellees do not challenge the Board's factual findings as to Bankers Trust's participation in the commercial paper market.

a small portion of the unsold amount of the issue. It did not commit itself to purchase unsold paper, but it did purchase in the secondary market commercial paper of issuers for which it had acted. Bankers Trust was the first commercial bank to enter the commercial paper market in competition with the investment banks; other commercial banks awaited the outcome of subsequent legal proceedings.

Becker and the SIA requested the staff of the Federal Reserve Board to review the legality of Bankers Trust's activities. The Board's general counsel, after extensive discussion with Becker, SIA, Bankers Trust and the SEC, issued an opinion declaring that commercial banks may lawfully act as agent for the issuer in the sale of commercial paper, "provided that the sales . . . are limited to purchasers to whom commercial banks normally sell participations in loans."[8] Becker and the SIA then requested the Federal Reserve Board to review the decision of its general counsel and to proscribe the commercial paper activities of member banks. After considering submissions by interested parties and conducting an on-site investigation of Bankers Trust's activities, the Board ruled that Bankers Trust's participation in the commercial paper market did not violate the Glass-Steagall Act or contravene public policy.[9]

In a carefully reasoned opinion the Board first concluded that there was no indication in the language or legislative history of the Glass-Steagall Act that Congress considered commercial paper to be a "security," in which banks were forbidden to deal.[10] The Board noted that banks had traditionally traded in commercial paper, and that the Act had been intended to strengthen banks in the exercise of traditional banking functions. The Board then turned to a "functional" analysis of the statutory terms, and concluded that, because

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8 Legal Division, Board of Governors of the Federal Reserve System, Commercial Paper Activities of Commercial Banks: A Legal Analysis 21 (28 June 1979), J.A. at 168.

9 Federal Reserve Statement, *supra* note 3.

10 *Id.* at 6-17, J.A. at 225-36.

commercial paper embodies short-term loans from a few sophisticated lenders to financially strong borrowers, it resembled a loan rather than a security for the purpose of the Glass-Steagall Act.[11] Because the Board ruled that commercial paper was not a "security," it did not reach the issue whether Bankers Trust was "issuing, underwriting, selling, or distributing" securities within the meaning of the Glass-Steagall Act.[12]

Subsequently, the Board issued guidelines to ensure that sale of third party commercial paper did not give rise to "unsafe or unsound practices."[13] These guidelines permitted banks to sell only prime quality third party commercial paper with maturity of nine months or less and in denominations of over $100,000. Banks could sell only to "financially sophisticated customers," and were forbidden to advertise to the general public. Sales to the bank's fiduciary accounts, parent holding companies and nonbank affiliates were also forbidden. Moreover, banks were required to maintain credit analyses of issuers, to limit the amount of paper sold for any issuer, and to maintain detailed records of sales, purchases and lines of credit extended. Finally, various disclosure requirements were imposed.

SIA and Becker sought review in the district court of the Board's ruling that commercial paper was not a "security." That court concluded that the Act's "plain language" barred commercial banks from trading in commercial paper.[14] It also found that the "broad framework" of the Act evinced Con-

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11 *Id.* at 17-20, J.A. at 236-39. The Board also rejected the arguments that the definition of "security" in the Securities Act of 1933, or considerations of public policy, militated against permitting Bankers Trust's sale of third party commercial paper. *Id.* at 20-27, J.A. at 239-46.

12 *Id.* at 24, J.A. at 243.

13 Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29333, 29334-35 (26 May 1981) [hereinafter cited as Guidelines].

14 *Becker*, 519 F. Supp. at 612-13.

gress' intent to institute a sweeping prohibition of commercial banks' engaging in investment banking activities.[15] Finally, in response to the Board's "functional" analysis of commercial paper, the court averred that "[o]ne factor . . . compels the conclusion that the commercial paper at issue here is [a security], and that crucial aspect is the role of Bankers Trust in the transaction."[16] For these reasons, the district court issued a declaratory judgment that the Board's ruling was contrary to law.[17]

We reverse. The district court gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act. Moreover, the language of the Act, its legislative history and the policies underlying it all support the Board's conclusions that commercial paper is not a "security" under the Act. We discuss each of these findings in turn.

II. STANDARD OF REVIEW

The Supreme Court recently had occasion again to delineate the standard to be applied in the review of an agency's interpretation of a statute which it is charged to implement.

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15 *Id.* at 614-15.

16 *Id.* at 615-16.

17 *Id.* at 616. The district court confined its holding to the question of whether the commercial paper at issue was a "security." Like the Board, it did not reach the question whether Bankers Trust was "underwriting" securities in violation of the Glass-Steagall Act. *See id.* at 616 n. 10.

Moreover, the district court did not explicitly rule on the validity of the Board's guidelines. However, because the guidelines in essence describe Bankers Trust's activities, it would be difficult to reconcile those guidelines with the district court's holdings. Conversely, if we find that Bankers Trust has acted lawfully, the activities of other commercial banks in compliance with the guidelines would be lawful as well. *See* Part IV (Conclusion) *infra*.

The task of the reviewing court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was '*sufficiently reasonable*' to be accepted by a reviewing court. . . . To satisfy this standard it is not necessary for a court to find that the agency's construction was the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[18]

In particular, the Board's ruling in the present case warrants deference for a number of reasons. First, the Board is "the type of agency to which deference should presumptively be afforded" because of *the scope of its authority.* Congress has vested the Board with "primary and substantial responsibility for administering" federal regulation of the national banking system.[19] The Board exercises "general supervisory" powers over member banks,[20] and is responsible to bring enforcement actions to prevent member banks from engaging in "unsafe or unsound" banking practices.[21] The Board thus formulates national banking policy, and, in implementing this policy, exercises broad rulemaking and adjudicative powers.

Second, deference to the Board's conclusions is warranted by its *expert knowledge of commercial banking.* "Not only because Congress has committed the [Federal Reserve] [S]ystem's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, . . . their judgment should be conclusive upon any

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18 *Fed. Election Comm'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 39, 102 S.Ct. 38, 46, 70 L.Ed.2d 23 (1981) (emphasis added) (citations omitted).

19 *Compare Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46.

20 *See* 12 U.S.C. § 248 (1976).

21 *See* 12 U.S.C. § 1818(b) (Supp. IV 1980). *See also* 12 U.S.C. § 501a (1976) (enforcement actions for violation of banking laws and regulations).

matter which . . . is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have . . . in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer [the system]."[22]

Third, deference to an agency's construction of the statute is called for because *the agency's decision applies general, undefined statutory terms*—"notes and securities"—to particular facts. While the Glass-Steagall Act contains a sweeping prohibition of commercial banks' trading in "securities," that term is, of course, not self-defining.[23] Moreover, we cannot assume that Congress intended the term to comprise a set of rigid and unchanging categories. Rather, such statutory drafting "leave[s] the agency with the task of evolving definitions on a case-by-case basis."[24] The regulatory structure of the banking laws must be permitted to adapt to the changing financial needs of our economy.[25] Congress has delegated to the Federal Reserve Board, rather than to this court, the complex task of applying the Act's general proscriptions to current business reality. We must therefore defer to the Board's interpretation of the statute if that interpretation is reasonable.

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22 *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947) (Rutledge, J. concurring). *See Board of Governors of Federal Reserve System* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21, 101 S.Ct. 973, 981 n.21, 67 L.Ed.2d 36 (1981) (citing *Agnew*) [hereinafter cited as *ICI II*].

23 *See infra* p. 143 [13a-16a].

24 *Puerto Rico* v. *Blumenthal*, 642 F.2d 622, 635 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 983, 101 S.Ct. 2315, 68 L.Ed.2d 840 (1981); *Chisholm* v. *FCC*, 538 F.2d 349, 358 (D.C. Cir.), *cert. denied*, 429 U.S. 890, 97 S.Ct. 247, 50 L.Ed.2d 173 (1976).

25 *Cf. M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978) (bank laws construed to permit "use of new ways of conducting the very old business of banking"). The current situation of the commercial paper market could not have been foreseen by Congress at the time the Glass-Steagall Act was passed: that market has changed drastically since the Depression. *See infra* note 85.

Finally, "*the thoroughness evident in the consideration* [of an agency's interpretation of a statute], *the validity of its reasoning*, [and] *its consistency with earlier and later pronouncements*" are factors that bear upon the amount of deference to be given to an agency's ruling.[26] In this instance, the agency's interpretation of the statute is based on a thorough and expert review of the relevant legal and policy considerations as well as of the facts of this case. The Board conducted an extensive inquiry into the operation of Bankers Trust commercial paper operations and the function of the commercial paper market; it clearly set forth its findings, conclusions, and bases for its reasoning.[27] And the Board's conclusion is consistent with prior decisions, including some roughly contemporaneous with the passage of the Glass-Steagall Act.[28]

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26 *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944) (emphasis added). *See Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46 (citing *Swift*); *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5, 98 S.Ct. 566, 574 n.5, 54 L.Ed.2d 538 (1978) (same).

27 Federal Reserve Statement, *supra* note 3.

28 For example, in 1933 the Board stated that commercial paper, defined as short-term paper issued for obtaining funds for current transactions and purchased by banks and corporations with temporarily idle funds, should not be considered an investment security. *See Federal Securities Act: Hearing on H.R. 4314 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-81 (1933); *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933); Federal Reserve Statement, *supra* note 3, at 11, J.A. at 230.

The assumption that commercial paper is a loan rather than a security pervades current banking regulation. The Board has ruled that issuance of commercial paper by a bank holding company does not fall within section 20 of the Glass-Steagall Act, the analogous provision for those companies. *See* 12 C.F.R. § 250.221(e)(1982). Under the rules of the Comptroller General's office, commercial paper holdings by banks are subject to the statutory limits on loans rather than investment securities. *See* 12 C.F.R. § 7.1180 (1982) (interpreting 12 U.S.C. § 84 (1976)); Federal Reserve Statement, *supra* note 3, at 11-12, J.A. at

For these reasons, which we have considered in prior opinions and which may frequently be found of use in evaluating administrative agency decisions, we should hesitate to overturn the Board's decision as long as that decision is a reasonable interpretation of the Glass-Steagall Act. And, as will appear below, the decision was reasonable. We do not, however, rest merely on the deference to the conclusions of the Federal Reserve Board. "[T]o accord deference is not to abdicate our duty to construe the statute, for 'the courts are the final authorities and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "[29] We therefore turn to an analysis of the application of the Glass-Steagall Act to the present case.

III. APPLICATION OF THE GLASS-STEAGALL ACT

Taking account of appropriate deference to the Board's expertise and administrative responsibility, we find that its ruling and the reasoning which supports it are essentially correct. An inquiry into the language and legislative history of the statute, and the policies underlying it, supports the Board's conclusion that the commercial paper marketed by Bankers Trust is not a "security" within the Glass-Steagall Act.

A. *Background*

Congress passed the Glass-Steagall Act in 1933, in response to what it perceived to be the abuses which resulted from the involvement of commercial banks in securities underwriting. Congress considered that commercial banks, by underwriting

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230-31. And commercial paper is treated as a loan for bank call reports and bank examination by the Federal Reserve Board. *Id.*

29 *Nat'l Ass'n of Recycling Inds., Inc. v. ICC*, 660 F.2d 795, 799 (D.C.Cir. 1981) (citations omitted).

stocks, had fueled the rampant speculation that preceded the Great Depression. Congress' principal concern in amending the banking laws, however, was to protect the solvency and integrity of the banks themselves.[30]

Stock underwriting by commercial banks undermined bank solvency in a number of ways. Most directly, commercial banks that engaged in underwriting tied up depositors' funds in the purchase of unsound or speculative securities. These investments placed commercial deposits at risk.[31] The promotional pressures exerted by underwriting activities also threatened bank solvency. To augment their commissions from securities sales, commercial banks used their credit facilities to lend to purchasers of securities.[32] Banks were also tempted to make unsound loans to client-issuers, because these loans might improve the balance sheet of these enterprises and thereby make their securities more marketable. When speculative ventures failed, these loans to purchasers and issuers were often not repaid, undermining bank solvency and depositor confidence in the banks.[33]

In addition to inducing commercial banks to purchase unsound securities and to make unsound loans, banks' participation in the securities market had more indirect effects on bank solvency. Banks' association with speculative securities ventures undermine the confidence of bank depositors in the stability of the banks.[34] Moreover, banks which underwrote

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30 *Senate Comm. on Banking and Currency, Operation of the National and Federal Reserve Banking Systems*, S. Rep. No. 77, 73d Cong., 1st Sess. 2-4, 6-13 (1933).

31 *Id.* at 9-10.

32 *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S.Res. 71 before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 87 (1931) (remarks of Chairman Glass) [hereinafter cited as *Hearings*].

33 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley).

34 *Id.*

stock issues could not be relied upon to give prudent and disinterested investment advice to their depositors, for they naturally had an incentive to urge depositors to purchase shares of the issues the bank was underwriting.[35] Finally, these banks would also "dump" excess issues of unmarketable securities on their own trust departments.[36]

Congress passed the Glass-Steagall Act to correct these abuses. The Act is a prophylactic measure designed to prevent commercial banks from being exposed to the dangers which inevitably followed upon their participation in investment banking. "Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system."[37]

B. *Statutory language*

Congress accomplished the separation of commercial and investment banking in sections 16 and 21 of the Glass-Steagall Act. We first ask whether the language of these sections clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged; if so, our inquiry necessarily comes to an end.[38]

Section 16 provides that a bank "shall not underwrite any issue of *securities or stock*" and shall not "purchase . . . for its own account . . . any *shares of stock* of any corpora-

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35 *Hearings*, *supra* note 32, at 237.

36 *Id.*

37 *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 634, 91 S.Ct. 1091, 1100, 28 L.Ed.2d 367 (1971) [hereinafter cited as *ICI I*].

38 *E.g.*, *Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11, 16, 100 S.Ct. 242, 245, 62 L.Ed.2d 146 (1979).

tion."[39] We can find nothing in the language of this section that explicitly articulates a congressional intent to bar commercial banks from trading in commercial paper. The terms "securities" and "stock" are not defined by the Act; section 16 in no way refers explicitly to notes, the generic financial term which Congress might have used to encompass commercial paper.[40] Indeed, banks are authorized to "discount and negotiate promissory notes, drafts, bills of exchange, and other evidences of debt. . . ."[41] It is clear, then, that section 16 does not prohibit banks from selling or underwriting *all* notes, but *only* "securities or stock"; and the section does not indicate whether the commercial paper at issue in this case is included within that statutory prohibition.

We turn then to section 21 of the Act, which forbids banks from underwriting "stocks, bonds, debentures, notes, or other securities. . . ."[42] Although this statutory provision explicitly refers to "notes," that term is susceptible of at least two interpretations. First, it may refer to a specific type of long-term debt security, one that closely resembles a bond or debenture but is of shorter maturity.[43] A note in this sense, like a bond or a debenture, is issued under an indenture agreement to raise money available for an extended period of time as part of the corporation's capital structure. An investment note

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39 12 U.S.C. § 24 Seventh (Supp. IV 1980) (emphasis added). The Act allows for several exceptions; the one pertinent here is that for "investment securities." *See infra* pp. 145-146 [19a].

40 *See infra* p. 143 [15a] & note 44.

41 12 U.S.C. § 24 Seventh (Supp. IV 1980).

42 12 U.S.C. § 378(a)(1) (1976). If the language of *either* section 16 *or* section 21 must be interpreted to prohibit Bankers Trust's marketing of commercial paper, that interpretation of course governs. *See generally ICI II, supra*, note 22, 450 U.S. at 62-65, 101 S.Ct. at 984-86.

43 *See, e.g.*, 1 A. Dewing, The Financial Policy of Corporations 180 (4th ed. 1941); G. Munn, Encyclopedia of Banking and Finance 132 (7th ed. 1973).

differs from these other instruments in that it matures more quickly—in a few, rather than twenty or more, years.

Second, the term "notes" is sometimes used generically to refer to *any* promissory instrument regardless of maturity or negotiability.[44] In this sense, commercial paper may also be referred to as a promissory "note." Such a note differs sharply from an investment "note": commercial paper is used to obtain short-term credit for current transactions, rather than capital funds for long-term projects. Its maturity generally ranges from one to two months, and rarely exceeds nine months.[45]

The language of section 21 suggests that Congress intended only to prohibit the marketing of investment notes—*i.e.*, that it intended to use "notes" in its more specific meaning. Each of the terms listed by Congress—"stocks," "bonds," "debentures" and "notes"—refers to a specific type of long-term investment security.[46] In contrast, "notes" in the more general sense would also include financial instruments, such as commercial paper, which have little in common with these long-term investment securities.[47] Moreover, "notes" used in its

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44 *See, e.g.*, G. Munn, *supra*, note 37, at 698 (defining "note" as a "written promise . . . to pay a certain sum of money to the . . . payee").

45 *See also infra* p. 149 [26a] & note 80.

46 "Stocks," of course, represent ownership interests in a corporation. "Bonds" are secured debt instruments, issued under a trust indenture agreement, that bear long-term maturities and are offered to the public in small denominations. "Debentures" differ from bonds only in that they are unsecured.

47 *See Third Nat'l Bank in Nashville v. IMPAC, Ltd.*, 432 U.S. 312, 322 & n. 16, 97 S.Ct. 2307, 2313 & n. 16, 53 L.Ed.2d 368 (1977) ("words grouped in a list should be given related meanings"); *Am. Maritime Ass'n v. Stans*, 485 F.2d 765, 768 (D.C.Cir. 1973) (same). *Cf. Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 1582, 6 L.Ed.2d 859 (1961) (statutory term "gathers meaning from the words around it").

Similarly, under the familiar principle that where general words follow specific words in an enumeration, the general words are

more general sense would include debt instruments such as bonds and debentures; the explicit statutory reference to the latter would then be redundant.[48] For these reasons, specific inclusion of the terms "stocks," "bonds," and "debentures" suggests that the narrower meaning of the term "notes" was intended. We conclude that the context in which the term "notes" is used strongly implies Congress' intent not to include commercial paper within the sweep of the Act's prohibition.

Both section 16 and section 21 thus demarcate a fundamental division between notes which represent commercial banking

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construed to embrace only items similar to those specifically enumerated, *see, e.g., Harrison v. PPG Inds., Inc.*, 446 U.S. 578, 588, 100 S.Ct. 1889, 1895, 64 L.Ed.2d 525 (1980), the phrase "or other securities would include *only* financial instruments with the economic characteristics of those listed, *see supra* note 46, *not* commercial paper.

The conclusion that commercial paper differs markedly from those instruments which Congress intended to prohibit commercial banks from underwriting depends ultimately upon an analysis of the relevant economic characteristics of these instruments, such as the characteristics noted in text. It is clear that commercial paper differs from the family of specific instruments listed in section 21 of the Act: we explain below the relevance of these differences to the policies wich Congress intended the Act to advance. *See infra* parts IIIC (legislative history) and IIIE (functional analysis of the commercial paper market).

48 *See Ass'n of Am. R.Rs. v. United States*, 603 F.2d 953, 964 (D.C. Cir. 1979) (presumption that "Congress [does] not employ superfluous language").

A third reason to reject a broad definition of the term "note" is that this definition would include a number of instruments in which banks have traditionally traded—for example, certificates of deposit, notes evidencing a mortgage and notes representing commercial loans in connection with a loan syndication. All of these clearly involve a "written promise to pay a certain sum to the payee," *see supra* note 44; their sale by banks would therefore be prohibited by appellees' reading of the statute. Moreover, it makes little sense to argue, as do appellees, that we may escape this quandary by interpreting the Glass-Steagall Act to prohibit only banking practices not otherwise authorized by the banking laws: The banks may only exercise expressly granted powers in any event. *See, e.g., Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972); *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968).

transactions—transactions which are, of course, permitted under the Act—and securities, such as investment notes, which commercial banks are prohibited from underwriting. Section 16 indicates this distinction by authorizing commercial banks to negotiate "promissory notes," while forbidding banks to negotiate "securities or stocks." Section 21 makes the distinction by barring banks from trading in specified instruments for raising capital as part of the permanent financial structure of a corporation—stocks, bonds, debentures and notes—while implicitly permitting transactions in other types of debt instruments. And the language of these sections, while not conclusive, strongly suggests that sale of commercial paper should be treated as a "loan" rather than a sale of securities for the purposes of the Act.

C. *Legislative history*

The distinction between commercial loans and securities emerges as well from an analysis of the legislative history. Throughout its debates on the causes of the imperiled state of the banking industry, Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties.[49] The commercial paper market was simply not part of the problem to which the Glass-Steagall Act was addressed.[50] Rather, Congress focused its attention on the commercial banks' participation in "speculative" securities markets: their extensive underwriting of long-term holdings of high risk stocks and bonds.

For example, the Senate Report on the Act notes that "[t]he outstanding development in the commercial banking system during the prepanic period was the appearance of excessive

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49 *See* Federal Reserve Statement, *supra* note 3, at 14-15, J.A. at 233-34.

50 This is particularly remarkable because, at the time the Glass-Steagall Act was passed, almost all commercial paper issued was purchased by commercial banks for their own account. *See* Hurley, *supra* note 5.

security loans, and of over-investment in securities. . . . [A] very fruitful cause of bank failures . . . has been the fact that the funds of various institutions have been so extensively '*tied up' in long-term investments*."[51] Congress condemned "the excessive use of bank credit in making loans for the purpose of *stock speculation*. . . ."[52] In short, the purpose of the Act was to reverse "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*."[53]

The distinction between bank participation in the securities and in the commercial paper markets is also illustrated in Congress' treatment of section 2(b) of the McFadden Act.[54] Section 2(b) limited the amounts of "investment securities" national banks could hold.[55] It is clear, however, that *commercial paper was not considered an "investment security"* under the McFadden Act: banks were left free to trade in commercial

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51 S. Rep. No. 77, *supra* note 30, at 8 (emphasis added).

52 *Id.* at 9 (emphasis added).

53 *Id.* at 4 (emphasis added). The hearings and floor debates of the Act are also replete with evidence that Congress was concerned with banks' speculation in long-term equity and debt securities rather than with their participation in the commercial paper market. *See, e.g.*, 77 Cong. Rec. 3725, 3837 (1933) (remarks of Sen. Glass); *Hearings, supra* note 32, at 1006-19; *Operation of the National and Federal Reserve Banking Systems; Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*: 72d Cong., 1st Sess. 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of president of American Bankers Association); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); *id.* at 9911-12 (remarks of Sen. Bulkley) (promotional pressures encouraging over-development of collateral-security loans and over-production of capital securities).

54 Ch. 191, 44 Stat. 1224 (1927).

55 44 Stat. at 1226 (codified at 12 U.S.C. § 24 Seventh (Supp. IV 1980)). The Act restricted bank holdings of the securities of any one obligor to twenty-five percent of the bank's holdings. *Id.* The Glass-Steagall Act further restricted the permissible amounts of these holdings. Ch. 89, sec. 16, 53 Stat. 162, 185 (1933) (later modified).

paper without restriction.[56] It is significant, therefore, that Congress preserved the provisions of the McFadden Act when it passed the Glass-Steagall Act six years later.[57] The legislative history of the Glass-Steagall Act provides no indication that Congress intended to change the McFadden Act's definition of "investment security."[58] Moreover, it is unlikely that Congress would consider commercial paper to be a "security" but *not* an "investment security."[59] Thus, Congress' incorporation of the McFadden Act into the revised banking laws, like other aspects of the legislative history, indicates an intent to continue to leave banks free to deal in commercial paper.

56 Federal Reserve Statement, *supra* note 3, at 9, J.A. at 228; 67 Cong. Rec. 3232 (1926); H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). Congress was legislating to control national banks' underwriting activities, which had sprung up in the early 1900s. In contrast, these banks had dominated the commercial paper market since the middle 19th century. *See* Federal Reserve Statement, *supra* note 3, at 10, J.A. at 229; A. Greef, The Commercial Paper House in the United States at 6-7, 15-18, 403-05 (1938).

57 Ch. 89, sec. 16, 53 Stat. 162, 185 (1933).

58 *See* S. Rep. No. 77, *supra* note 30, at 16 (banks permitted to purchase and sell investment securities "to the same extent as heretofore").

59 The conclusion that commercial paper is not a "security" or "stock" would follow *a fortiori* from the conclusion that commercial paper is not an "investment security." If commercial paper is a security but not an investment security, banks would be entirely forbidden from purchasing, selling, or underwriting commercial paper, while permitted, subject to the regulation of the Comptroller of the Currency, to purchase or sell corporate debt instruments. This would be quite anomalous, for corporate debt instruments threaten to a far greater degree to cause the evils at which the Glass-Steagall Act is aimed. Moreover, if commercial paper were deemed to be a "note" within section 21 of the Glass-Steagall Act, it ought also to be a "marketable obligation[ ] evidencing indebtedness . . . in the form of [a] note[ ]"—*i.e.*, an "investment security"—under section 16. That the legislative history and administrative implementation of the McFadden Act indicate clearly that commercial paper is not an "investment security" implies therefore that it should not be considered a "note" for the purposes of the Glass-Steagall Act.

D. *The Analogy to the Securities Laws*

Plaintiffs suggest that we may infer Congress' intent from its use of the term "security" in two contemporaneous statutes—the Securities Act of 1933 and the Securities Exchange Act of 1934. Both acts define "security" to include "any note."[60] There is no reason, however, to assume that Congress intended that term to bear the same meaning in these different statutory contexts. Congress enacted the Glass-Steagall Act primarily to protect *bank depositors*.[61] By contrast, "[t]he primary purpose of the [Securities Acts] of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and *the need for regulation to prevent fraud and to protect the interest of investors*."[62]

Therefore, although Congress used the term "securities" in both the Glass-Steagall and the Securities Acts, different interpretations of "securities" may follow upon the differing regulatory purposes behind the Acts.[63] "Because securities transactions are economic in character Congress intended the application of [the Securities Acts] to turn on the *economic realities underlying a transaction*. . . ."[64] Similarly, the Court has defined the term "securities" in the Glass-Steagall Act by

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60 15 U.S.C. § 77b(1)(1976) (Securities Act); *id.* § 78c(a)(10) (Securities Exchange Act).

61 *ICI II, supra* note 22, 450 U.S. at 61 & n. 27, 101 S.Ct. at 984 & n. 27. *See generally supra* pp. 141-143 [11a-13a].

62 *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975) (emphasis added).

63 The Supreme Court's recent interpretations of these provisions of the Glass-Steagall Act make no reference at all to the securities laws. *See generally ICI I, supra* note 37; *ICI II, supra* note 22.

64 *United Housing Found., Inc.*, 421 U.S. at 849, 95 S.Ct. at 2059 (emphasis added).

analyzing the economic policy behind the Act—to protect bank depositors from the hazards which ensue when commercial banks enter the investment banking business.[65] In short, the Glass-Steagall Act uses the term "security" to fence off investment banking activities from commercial banks; the securities laws use the term to define the capital markets whose economic functioning is to be regulated by the securities laws. Clearly, the scope of the term may differ in these differing contexts. We must assign the term "security" a different meaning in the Glass-Steagall and the Securities Acts if a different interpretation is called for by the respective policies of those Acts.[66]

The Supreme Court recently reaffirmed this approach to the Securities Acts in *Marine Bank* v. *Weaver.*[67] "The [Securities Exchange] Act was adopted to restore *investors' confidence in the financial markets.* . . . We have repeatedly held that the test [of whether an instrument is a "security"] 'is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.' "[68] Therefore, "[e]ach transaction must be analyzed and evaluated on the basis of the content of

65 *See infra* p. 148 [23a-25a] & notes 72-76.

66 Appellees emphasize that, because Congress *defined* "security" in the Securities Act to include "any note," it must have intended "security" in the Glass-Steagall Act to mean the same thing. But all the example of the Securities Acts shows, of course, is that Congress is capable of using "securities" to include "all notes" when it clearly defines the term in that way. Indeed, the example of those Acts suggests that, if Congress had intended so sweeping a definition of "security" in the Glass-Steagall Act, it would have enunciated such a definition in the Act. *Cf. American Tobacco Co.* v. *Patterson*, U.S. at n. 6, 102 S.Ct. 1534 at 1539 n. 6, 71 L.Ed.2d 748 ("fundamental distinction" should not be imported into a statute unless Congressional intent is clearly expressed); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 572, 99 S.Ct. 2479, 2487, 61 L.Ed.2d 82 (1979) ("when Congress wished to provide [remedy], it knew how to do so and did so expressly").

67 ___ U.S.___, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982).

68 *Id.* at ___, 102 S.Ct. at 1222 (emphasis added) (citations omitted).

the instruments in question, the purposes intended to be served, and the factual setting as a whole."[69]

In deciding that a certificate of deposit was not a security, *Marine Bank* noted two facets of the economics of these certificates: first, holders receive a fixed rate of interest rather than dividends based on profits; second, "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under . . . the federal securities laws since the holders of bank certificates of deposit are abundantly protected under federal banking laws."[70] In short, the Court focused on the potential economic gains and losses of the *investors*, who are the intended beneficiaries of federal securities regulation, in deciding whether the purposes of that regulation would be furthered by its application to the instrument in question. A different focus of analysis is called for under the Glass-Steagall Act, which aims at protecting the integrity of *banks* and the financial resources of *depositors* rather than *investors*.

We conclude that the meaning of the term "securities" under the securities laws is of little immediate relevance to the problem before us; rather, the example of these laws suggests the need for a careful economic analysis of the commercial paper market itself.

E. *Functional Analysis of Commercial Paper*

The language and the legislative history of the Glass-Steagall Act strongly suggest that commercial paper should be viewed as a loan rather than as a "security" for the purposes of the Act. However, as we have seen, neither the language nor direct evidence from the legislative history is decisive of the question before us. There is no foolproof formula by which we can decide whether the commercial paper marketed by Bankers Trust constitutes a "security." Rather, as the Board observed,

> a broad generic or literal reading of the term "security" would likely encompass a number of instruments that

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69 *Id.* at ____, n. 11, 102 S.Ct. at 1225, n. 11.

70 *Id.* at ____, 102 S.Ct. at 1225.

> banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress.[71]

Because neither the literal language of the statute nor other expressions of congressional intent available to us directly indicate whether commercial paper is a "security," it is necessary to conduct a "functional analysis" of Bankers Trust's commercial paper to resolve this question. The problem becomes whether classifying commercial paper as a "security" would further the policies of the Act. As the Board phrased this inquiry:

> [I]f a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.[72]

In adopting this functional analysis, the Board followed the Supreme Court's reasoning in its recent cases construing the Glass-Steagall Act. In *Investment Company Institute* v. *Camp* (*ICI I*) the Court noted that

> Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities. The Glass-Steagall Act reflected a determination that policies . . . which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the "hazards"

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71 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 237.

72 *Id.*

and "financial dangers" that arise when commercial banks engage in the activities proscribed by the Act.[73]

Thus, if confronted with a banking practice which involves the sale of securities and for that reason threatens the "hazards" at which the Act is aimed, neither the Federal Reserve Board nor this court is free to "balance" these hazards against the perceived benefits of the proposed practice. If the practice does *not* threaten to cause these hazards, however, we need undertake no such balancing. Rather, we effectuate the will of Congress by concluding that the proposed banking practice is not within the scope of the statutory proscription.

For example, in *ICI I* the Court found that the bank's sale of participations in a bank-sponsored mutual fund posed the dangers that the Glass-Steagall Act was designed to prevent; the Court concluded that these participations were securities within the meaning of the Act.[74] Once these participations were found under this functional analysis to be "securities," the "literal language" of the Act prohibited sale by the bank.[75]

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73 *ICI I, supra* note 37, 401 U.S. at 629-30, 91 S.Ct. at 1098.

74 *Id.* at 635-38, 91 S.Ct. at 1101-02.

75 *Id.* at 639, 91 S.Ct. at 1103. *See also ICI II, supra* note 22, 450 U.S. at 65-66, 1-1 S.Ct. at 986 (analyzing *ICI I*) ("This Court's . . . determination [that the units of participation were securities] led inexorably to the conclusion that § 16 had been violated."). *ICI II* posed a different problem of statutory interpretation, as the Court itself noted. *Id.* at 66, 101 S.Ct. at 986. There, it was indisputable that the transactions under scrutiny involved "securities"; the question before the Court was whether the banks were "engaged in the business of issuing, underwriting, selling, or distributing" securities. Again, the Court embarked upon an analysis of the "hazards contemplated [by] Congress in enacting the Glass-Steagall Act" in order to conclude that the Act had not been violated. *Id.* at 66-67, 101 S.Ct. at 986-87.

Because we find that the commercial paper marketed by Bankers Trust is not a "security," we need not reach the issue, which arose in *ICI II*, of whether the bank is engaged in "underwriting" within the meaning of the Glass-Steagall Act.

The Federal Reserve Board, in resolving the present case, therefore correctly focused on whether the commercial paper marketed by Bankers Trust functioned economically as a loan or as a security. Only if commercial paper displayed the economic characteristics of a "security" would the marketing of commercial paper by Bankers Trust cause the hazards the Act was designed to prevent. The Board concluded that, in all relevant respects, the commercial paper had the economic characteristics of a loan.[76] We agree.

It is useful to review the traditional lending functions of commercial banks. The commercial lender extends *short-term* credit to businesses to finance immediate needs for working capital.[77] To assure itself of timely repayment, the commercial bank carefully evaluates the credit-worthiness of the borrower and the borrower's representations as to the use of funds. In recent years, the lender has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies.[78]

We find that the commercial paper at issue here has the economic characteristics of a traditional loan. Purchase of commercial paper, like lending by a commercial bank, represents a very reliable means by which the lender may earn a return on excess cash over a short period of time. Several features of the commercial paper market are salient in this respect.

First, the default rate on commercial paper is extremely low: only highly solvent corporations, with the best possible bond ratings, are able to market commercial paper. Indeed, the default rate on commercial paper is much lower than that on

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76 Statement, *supra* note 3, at 17-20, J.A. at 236-39.

77 *See, e.g.*, D. Hayes, Bank Lending Policies 89-91 (1977); J. Culbertson, Money and Banking 308-09 (2d ed. 1977). In considering the Glass-Steagall Act, Congress emphasized the distinction between short-term and long-term capital financing. *See supra* p. 145 [18a] & notes 52-53.

78 *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Lawyers 537, 538 (1977).

ordinary commercial loans made to high-grade commercial customers.[79]

Second, Bankers Trust commercial paper, like most commercial loans, is of very short maturity: it is generally redeemable at face value within 30 to 90 days.[80] Short maturity not only makes commercial paper a very liquid investment; it also reduces risk, because the financially strong corporations which can issue commercial paper are unlikely to deteriorate over the short period during which purchasers must hold the paper.

Third, because commercial paper is sold by Bankers Trust in denominations averaging one million dollars or more,[81] this paper is placed only with sophisticated purchasers—large institutions such as pension funds, money market mutual funds, insurance companies and nonfinancial corporations with large amounts of idle cash.[82] These purchasers, like commercial banks, are well able to evaluate the riskiness of the investments by verifying representations about the issuers. Three indepen-

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79 Federal Reserve Statement, *supra* note 3, at 3, J.A. at 222; Hurley, *supra* note 5, at 526-29. The Board's empirical studies found that the default rate on commercial paper is only a fraction of that on commercial loans. Companies which began to experience financial difficulties, such as Chrysler Financial Corp. and International Harvester Credit, must withdraw from the commercial paper market. Ironically, these corporations turn to commercial banks to meet their needs for current funding.

80 *See* Report from the Board's On-site Investigation of Bankers Trust 2 (8 May 1980) (average maturity of Bankers Trust notes 60 days), J.A. at 200 [hereinafter cited as Report]; Federal Reserve Statement, *supra* note 3, at 2, J.A. at 221. *See also* Hurley, *supra* note 5, at 530; Comment, *supra* note 5, at 364. According to a Federal Reserve Board survey, the maturities of short-term commercial and industrial loans range from 36 to 105 days. 67 Fed. Res. Bull. A26 (Dec. 1981).

81 *See* Report, *supra* note 80, at 2, J.A. at 200. The minimum denomination Bankers Trust will sell is $100,000.

82 Hurley, *supra* note 5, at 529; Comment, *supra* note 5, at 362-66.

dent rating services also conduct thorough periodic investigations of issuers' financial condition.[83]

For all these reasons, investment in commercial paper, far from resembling securities speculation, is less risky even than banks' ordinary commercial lending.[84] The key difference between the commercial paper sold by Bankers Trust and the traditional lending of commercial banks is that capital is lent by other investors rather than by the bank.[85] In the traditional loan transaction, the commercial bank *purchases* commercial paper; in the present case, the bank acts as agent in the *sale* of commercial paper. The bank is simply on the other side of the transaction. The question which faced the Board is whether commercial paper should be considered a "security" merely because the bank acts as the seller rather than the purchaser of the commercial paper—*i.e.*, whether the role of the bank in and of itself makes the transaction one prohibited by the Glass-Steagall Act.[86]

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83 *See* sources cited at note 82 *supra*.

84 Notably, securities differ strikingly from loans in all three respects. First, purchasers of securities, unlike purchasers of commercial paper, may liquidate their holdings, if at all, only at whatever price the market is currently paying for the stock. Second, because this price will fluctuate with the fortunes of the firm and with general economic conditions, holding securities is risky (though of course the degree of risk will depend on the profitability of the enterprise and the terms of the security agreement). Third, securities are generally available in much smaller denominations than commercial paper, so that they may be traded by the public on the open market.

85 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 238. When Congress passed the Glass-Steagall Act, this difference was less marked than it has been in recent years: banks not only arranged loans in private transactions, but also purchased the vast bulk of instruments sold through the commercial paper market. *See id.* at 18, J.A. at 237; Hurley, *supra* note 5, at 529. *Compare supra* p. 148 [25a] & n. 78 (in commercial bank loan, lender may be either the bank itself or a syndicate of other lenders).

86 *See Becker*, 519 F. Supp. at 615-16.

We agree with the Board that Bankers Trust may sell as well as purchase commercial paper. The bank's role as seller does not threaten the bank with those dangers which the Glass-Steagall Act was designed to prevent. Because commercial paper is like a loan rather than a security, marketing of commercial paper by the bank does not have the same economic impact on the bank as would marketing of securities.

This is confirmed by an analysis of the dangers which the Glass-Steagall Act was designed to prevent.[87] One such danger was that bank underwriting of *securities* may "tie up" depositors' funds in speculative securities. Bankers Trust's sale of commercial paper does not create this danger because of the features of commercial paper already noted. First, the bank acts simply as an agent in the sale of commercial paper; it does not agree to purchase the paper on its own account—*i.e.*, with the funds of depositors.[88] Second, commercial paper is of prime quality, sold only by corporations with well-established credit ratings: commercial paper is not a "speculative" holding.[89] Third, commercial paper is held by the lender only for 30 to 90 days:[90] the lender may readily convert his holdings to cash and does not bear the risk of long-term fluctuations in the value of the enterprise.

The other set of dangers addressed by the Glass-Steagall Act comprises the conflicts of interest that arise when a commercial bank underwrites securities.[91] Again, Bankers Trust does not face these conflicts.

First, the bank cannot use its credit facilities in order to facilitate sale of its commercial paper. Because the interest on a commercial loan is higher than that paid out on commercial

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87 *See supra* pp. 141-43 [11a-13a].

88 Report, *supra* note 80, at 4, J.A. at 202; Federal Reserve Statement, *supra* note 3, at 2.

89 *See supra* pp. 148-149 [25a-27a].

90 *See supra* p. 149 [26a-27a].

91 *See supra* pp. 142-143 [12a-13a].

paper, a purchaser of commercial paper would not use a commercial loan to finance its purchases.[92] Conversely, the bank is under no incentive to advance unsound loans to shore up its issuers of commercial paper, because these issuers must be, by the nature of the commercial paper market, financially sound.[93]

Second, Bankers Trust is not in a position to abuse its reputation for prudence, or give unreliable financial advice to its depositors, in order to promote the sale of commercial paper. Commercial paper is purchased only by large sophisticated buyers who are capable themselves of evaluating the wisdom of their investment.[94] Moreover, commercial paper is very low-risk, and is issued only by very solvent corporations about whose financial prospects information is widely available.[95] It is inconceivable that a commercial bank such as Bankers Trust could, under these conditions, seek improperly to influence potential purchasers of commercial paper.[96]

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92 *See* Guidelines, *supra* note 13, at 29334. *See also* Report, *supra* note 80, at 4, J.A. at 202 (no evidence that funds borrowed from Bankers Trust are used to purchase its commercial paper).

93 *See supra* pp. 148-149 [25a-27a].

94 *See supra* p. 149 [26a-27a].

95 *See supra* p. 148 [25a-26a].

96 Finally, Bankers Trust may not "dump" its commercial paper through its trust department, for the Federal Reserve Guidelines prohibit bank sales of commercial paper to fiduciary accounts to which the bank gives investment advice. *See* Guidelines, *supra* note 13, at 29335 (Guideline #7). Insofar as the conflict of interest presented here may be entirely eliminated by an authorized regulation of the Board, it can hardly be said to pose one of the "subtle hazards" against which the Act is directed. *ICI I*, *supra* note 37, 401 U.S. at 630, 91 S.Ct. at 1098. *See also ICI II*, *supra* note 22, 450 U.S. at 66-67, 101 S.Ct. at 986 (relying on Board guidelines in finding no "underwriting" by banks); *cf. Marine Bank*, ___ U.S. at ___, 102 S.Ct. at 1225 (regulation of certificates of deposit by securities laws unnecessary because of extensive federal banking regulation).

Finally, the bank's reputation for prudence will not suffer by its association with the issue of commercial paper. Commercial paper is a highly sound short-term investment. And even if a commercial paper issuer were to default, the sophisticated purchasers of commercial paper will understand that this paper is not backed by the guarantees on commercial bank deposits.

The Board's "functional analysis" leads inexorably to the conclusion that Bankers Trust's commercial paper is not a "security" within the meaning of the Glass-Steagall Act. Transactions in commercial paper display the key economic characteristics of a commercial bank loan; and, because of these characteristics, Bankers Trust's dealings in commercial paper pose none of the hazards the Glass-Steagall Act was designed to prevent.

IV. CONCLUSION

We thus agree with the Board that Bankers Trust may continue to deal in commercial paper without violating the Glass-Steagall Act. The commercial paper it markets is not a "security" within the prohibitions of the Act. Moreover, our reasoning applies to other commercial paper which falls within the Board's guidelines—*i.e.*, prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public.[97] Commercial banks which deal in this paper are not subject to the risks which the Glass-Steagall Act was designed to prevent. We hold therefore that commer-

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97 *See* Guidelines, *supra* note 13, at 29334 (Guideline # 1). The Board's Guidelines, in addition to defining permissible types of commercial paper and permissible purchasers and sellers, require forms of disclosure, record-keeping, and credit analysis by commercial banks. *See supra* p. 8. These requirements are directed against the danger that sale of third-party commercial paper might involve "unsafe or unsound [banking] practices." In finding that the transactions regulated by the Guidelines do not involve a sale of *securities*, we do not rely on these additional requirements.

cial banks may sell third party commercial paper provided that they comply with the Board's guidelines.

It is appropriate to note, however, the limits to this holding. It is conceivable that another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a "security" under the Glass-Steagall Act. Commercial bank involvement in the market for such commercial paper may well undermine bank solvency or create unavoidable conflicts of interest. Moreover, the present case does not require us to decide whether Bankers Trust is engaged in "underwriting." A commercial bank is permitted to underwrite commercial paper so long as commercial paper is not a "security." If other species of commercial paper prove to be a "security," however, the issue what constituted "underwriting" of commercial paper would then have to be decided.

Our opinion does not touch directly on other species of commercial paper. As the commercial paper market and banking practices continue to evolve, the Board will be called upon to determine in varying fact situations the scope of activities that Congress intended to permit banks to undertake. But these hypothetical situations are irrelevant to the problem before us. Because the Board correctly applied its functional analysis to the instant case, the judgment of the district court is *Reversed*.

ROBB, *Senior Circuit Judge*, dissenting:

I dissent. In my opinion the majority's holding contravenes the fundamental policy of the Glass-Steagall Act. That Act seeks to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions. The majority decision violates this separation of functions by finding no difference under the Act between a lender in a commercial loan transaction and a seller in the sale of third-party commercial paper.

Although offering various justifications, the majority ultimately rests its holding on a "functional analysis" of Bankers

Trust's third-party commercial paper sales. In its functional analysis, the majority dismisses the difference between the bank's role as "purchaser" in a commercial loan transaction and its role as "seller" in a third-party commercial paper transaction as a case of the bank "simply [being] on the other side of the transaction." *Ante* at 150 [27a]. This distinction, however, is determinative under the Act. Through the Act Congress sought a complete separation of commercial banking from investment banking. *See Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629, 632, 91 S.Ct. 1091, 1098, 1099, 28 L.Ed.2d 367 (1971). *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. 46, 62, 101 S.Ct. 973, 984, 67 L.Ed.2d 36 (1981). The critical distinction between commercial banking and investment banking is the bank's role in the transaction.

When a bank lends money it is the investor. Following a thorough credit analysis of the potential borrower, the bank decides whether to approve the loan. A loan that the bank has approved and funded constitutes an asset of the bank for which the bank has placed its funds at risk. The bank's generation of income and collection of principal are dependent on the wisdom of the bank's credit decision, the adequacy of the loan provisions, and the bank's perseverance in collecting the loan.

In contrast, when a bank markets third-party commercial paper, it is the seller, not the investor. As seller, the bank has less incentive to conduct a thorough credit analysis of the commercial paper issuer because the bank, unlike an investor, does not place its funds at risk. The bank earns its fee upon closing the sale of the commercial paper. Once the sale is complete, the bank has no direct financial interest in the issuer's ability to meet its commercial paper obligations.

Ignoring the differences in the bank's roles as lender and as seller, the majority characterizes commercial loans as "short-term" transactions and then avers that selling commercial paper is no different than making a commercial loan because both transactions have short maturities. *Ante* at 143-144 [25a-27a]. This analysis fails for two reasons. First, any interpreta-

tion of the Act must focus on the bank's role in the transaction with a view to maintaining the Act's separation of banking functions. The majority's focus on maturities provides no help in determining whether the bank's role in the transaction violates the Act. Second, the basic premise of the majority's analysis is incorrect. Commercial lending is not limited to short-term loans. Longer maturity loans for the acquisition of fixed assets and for permanent increases in working capital are important commercial lending services which the majority conveniently ignores. *See* D. Hayes, *Bank Lending Policies*, 89, 107, 109 (2d ed. 1977); G. Munn, *Encyclopedia of Banking and Finance* 892 (7th ed. 1973). *See generally Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

Similarly, an analogy between commercial paper sales and commercial loans, based on low default rates and the sophistication of the investors, *ante* at 144 [25a-27a], is not helpful. Relying on these factors, a bank could transform "transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks." *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F.Supp. 602, 615 (D.D.C. 1981).

The majority says that analysis of the hazards of mixing commercial and investment banking "confirms" the result reached through its functional analysis. I reach the opposite conclusion. In *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971), the Supreme Court lists several hazards that arise when commercial banks become peddlers of securities. First, commercial banks may suffer losses from imprudent security investments. *Id.* at 630, 91 S.Ct. at 1098. Second, "the bank's salesman's interest might impair its ability to function as an impartial source of credit." *Id.* at 631, 91 S.Ct. at 1099. Third, commercial banks may lose customer good will if their depositors suffer losses on investments made in reliance on the bank's involvement in the transaction. *Id.* Fourth, commercial banks may use their reputation for prudence to further their securities sales and subject that reputation to the risks necessarily incident to the investment banking business. *Id.* at 632, 91 S.Ct. at 1099. Finally,

the bank's promotional interests could conflict with its commercial banker obligation to render disinterested investment advice. *Id.* at 633, 91 S.Ct. at 1100.

The majority makes short work of the hazards discussed in the *Camp* decision. Those hazards, in the majority's view, are irrelevant here because commercial paper is a "prime quality", "very low-risk" investment, issued by "financially sound" issuers, and sold to "sophisticated" investors. *Ante* at 150-151 [28a-30a]. The majority's self-fulfilling analysis misses the point. "Prime quality" and "very low-risk" are characterizations that are justified only after an investment has been terminated without any investor loss. The drafters of the Act were certainly more wary of such characterizations in 1933 than the majority is today. The Act has no provision permitting bank sales of securities which are "prime quality" or "very low-risk".

To determine whether the bank's sale of third-party commercial paper involves the hazards that the Act seeks to prevent, we must take the perspective of the Act's drafters. The recent Penn Central experience provides such a perspective. *See generally* Staff of Securities & Exchange Commission, 92d Cong., 2d Sess., *Report to Special Subcomm. on Investigations of the House Comm. on Interstate and Foreign Commerce, The Financial Collapse of the Penn Central Company* (Subcomm. Print 1972) [hereinafter cited as *Penn Central Report*]. As a consequence of its bankruptcy on June 21, 1970 the Penn Central Transportation Company defaulted on $82.5 million in commercial paper. *Id.* at 1. Goldman, Sachs & Co., the nation's largest commercial paper dealer, had sold the commercial paper during the seven months preceding the bankruptcy. *Id.* at 290. The National Credit Office, a wholly-owned subsidiary of Dun & Bradstreet, Inc., had given Penn Central's commercial paper its highest rating, "prime", until June 1, 1970. *Id.* at 283. The investors, whom Goldman, Sachs & Co. described as "sophisticated" and "capable of making their own investment decisions," had purchased Penn Central commercial paper in $100,000 denominations. *Id.* at 290.

A review of the *Camp* warnings in light of the Penn Central experience presents a picture very different from that which the

majority draws. First, although Bankers Trust makes no commitment to purchase unsold commercial paper, it makes clear in its promotional letter to commercial paper issuers that such purchases are within the ambit of its investment services.

> However, in those rare occasions in which we would be unable to satisfy all of [the issuer's] requirements through the placement of paper with investors, we may, from time-to-time and without prior commitment, lend [the issuer] money at the commercial paper rate, and take back a commercial paper note.

(J.A. at 61). *See also* J.A. at 27, 50. The majority states that bank purchases of commercial paper would not present a problem because commercial paper is "prime quality, [is] sold by corporations with well-established credit ratings," and is a short-term investment. *Ante* at 150 [28a-30a]. Yet a bank's purchase of Penn Central's commercial paper which fit the majority's criteria just three weeks before it became worthless, would have been a perfect example of the hazard of "imprudent investment" that the Act seeks to prevent.

Second, the majority states that commercial paper issuers are "financially sound" companies and, therefore, have no need for commercial loans to strengthen their financial position. *Ante* at 150-151 [28a-30a]. However, as the Penn Central case demonstrates, commercial paper issuers are not exempt from financial difficulties. A bank's interests in handling the issuer's commercial paper sales and in protecting the bank's reputation for sound financial decisionmaking could "distort" its credit decisions or lead to unsound loans" to issuers for whom the bank regularly sells commercial paper. *Investment Co. Institute* v. *Camp*, 401 U.S. at 637, 91 S.Ct. at 1102.

The third hazard discussed in the *Camp* decision arises when a bank sells third-party commercial paper under any circumstances less idealistic than those which the majority envisions. Bank depositors who are financially able to purchase commercial paper in large denominations are likely to be among the bank's most important and influential clientele. Loss of their good will as a result of losses on investments which the bank

recommended and sold could be detrimental to the bank's commercial operations.

Finally, the majority makes the indisputable statement that when a bank sells "very low-risk" commercial paper of "very solvent" corporations to "large, sophisticated" investors the bank is not in a position to abuse its reputation for prudence or to give unreliable financial advice. *Ante* at 150 [28a-30a]. However, commercial paper sales that initially fit the majority's criteria may, before the investors are repaid, create hazards that the Act seeks to prevent.

Goldman, Sachs & Co. sold $5 million of the commercial paper of Penn Central, the nation's fourth largest corporation, to American Express Company, a sophisticated investor, on May 1, 1970. *Penn Central Report* at 286, 291. That sale, following several indications of major problems at Penn Central, *id.* at 279-86, and preceding the Company's collapse by just seven weeks, demonstrates the hazards present when there is a financial incentive to give unreliable advice. Had Bankers Trust been Penn Central's securities peddler, the association with Penn Central's collapse together with the resulting lawsuits which the bank would have had to defend would have severely damaged the bank's reputation for financial prudence. *See* Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi.L.Rev. 362, 378-79 nn. 112-13 (1972).

We must analyze the Act with the intent of its drafters as our guide. The Act was a "drastic step", *Investment Co. Institute* v. *Camp*, 401 U.S. at 629, 91 S.Ct. at 1098, taken during a bleak period in our country's banking history. Its drafters intended a complete separation of commercial banking from investment banking without regard to the likely "soundness" of the securities which a bank might sell. Senator Bulkley stated this uncompromising position at the time of the Act's passage: "If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep the banks out of the investment security business." *Investment Co. Institute* v. *Camp*, 401 U.S. at 634, 91 S.Ct. at 1100 (quoting 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley)). Permitting a bank

to sell third-party commercial paper presents the same hazards that "Congress determined . . . made it necessary to prohibit . . . [investment banking] activity to commercial banks." *Investment Co. Institute* v. *Camp*, 401 U.S. at 636, 91 S.Ct. at 1101. As a result, we must look closely to determine whether the Act prohibits banks from selling third-party commercial paper.

Unlike the majority, I find the Act's language helpful in determining whether commercial paper is a "note" or "security". For our purposes the Act raises two issues. The first issue is whether commercial paper is an instrument with which the Act is concerned—"stocks, bonds, debentures, notes, or other securities," 12 U.S.C. § 378(a)(1) (1976). The second issue is whether Bankers Trust is engaged in the "issuing, underwriting, selling, or distributing," *id.*, activities which the Act prohibits.

The majority characterizes the terms "stocks", "bonds", "debentures", and "notes" as "specific type[s] of long-term investment securit[ies]." *Ante* at 143-144 [15a]. The majority concludes that a broader definition of the term "notes" would be inappropriate because it would include instruments such as commercial paper "which have little in common with these long-term investment securities." *Ante* at 144 [15a]. The majority's reliance on maturities to force a narrow meaning onto the terms of the Act is misplaced. The Supreme Court has interpreted the Act's terms broadly.

> [N]othing in the phrasing of either § 16 or § 21 . . . suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Investment Co. Institute v. *Camp*, 401 U.S. at 635, 91 S.Ct. at 1101. *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. 986. The terms "stocks", "bonds", "debentures", and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the

breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments which a corporation might seek to market. Relying "squarely on the language . . . of the Glass-Steagall Act," *Board of Governors of Federal Reserve System* v. *Investment Co Institute*, 450 U.S. at 65, 101 S.Ct. at 986. I would find that commercial paper is a type of instrument with which the Act is concerned.

Although analysis of the Act's terms and of the hazards with which the Act is concerned requires a finding that commercial paper is a "note or other security" under the Act, our inquiry is not complete. There remains the second issue of whether Bankers Trust's commercial paper sales is an activity which the Act prohibits. However, neither the Federal Reserve Board nor the District Court reached this second issue. *A.G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 519 F. Supp. 602, 616 n. 10 (D.D.C. 1981). Therefore the second issue is not before us on this appeal.

I would affirm the District Court's finding that commercial paper is a "note or other security" under the Act, and would remand this case for the further determinations suggested in this dissent.

Opinion of the District Court

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. Nos. 80-2614, 80-2730

July 28, 1981

A.G. BECKER INCORPORATED,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

APPEARANCES:

Harvey L. Pitt, Henry A. Hubschman, Edson G. Case, Jr., Fried, Frank, Harris, Shriver & Kampleman, Washington, D.C., for Becker.

John M. Liftin, James B. Weidner, Janet R. Zimmer, Rogers & Wells, Washington, D.C., for SIA.

Richard M. Ashton, Neal L. Petersen, James V. Mattingly, Jr., Federal Reserve Board, Washington, D.C., for defendants.

JOYCE HENS GREEN, *District Judge.*

Pending before the Court in these consolidated actions are the parties' cross motions for summary judgment and the defendant's alternative motion to dismiss, with supporting memoranda. Plaintiffs are A.G. Becker, Inc. ("Becker"), a securities broker and dealer registered with the Securities and Exchange Commission, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers. They challenge a decision of the Board of Governors of the Federal Reserve System ("the Board"), which, with its individual members, are the defendants in this action. The dispute presents provocative questions concerning the delicately balanced regulatory system enacted by Congress to control the activities of the nation's banks in financial markets.

In the summer of 1978, Bankers Trust Company ("Bankers Trust"), a state chartered member bank of the Federal Reserve System, began offering for sale third party commercial paper, that is, commercial paper issued by corporations not related to the bank.[1] This effort included a marketing campaign aimed at

1 A succinct definition of commercial paper is offered in Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi. L. Rev. 362 (1972):

> Commercial paper consists of unsecured, short-term promissory notes issued by sales and personal finance companies; by manufacturing, transportation, trade, and utility companies; and by the affiliates and subsidiaries of commercial banks. The notes are payable to the bearer on a stated maturity date. Maturities range from one day to nine months, but most paper carries an original maturity between thirty and ninety days. When the paper becomes

issuers of commercial paper, whereby Bankers Trust agreed to act as a seller of commercial paper, performing services competitive with securities dealers. As part of this advertising, Bankers Trust offered to lend the issuer of commercial paper money equal to the amount of paper to be sold and, if the bank were unable to sell all of the issuer's paper, to take back notes reflecting the amount of paper unsold.

Becker and SIA expressed concern to the staff of the Board of Governors as to the legality of Bankers Trust's actions in a letter sent in November, 1978. Following this correspondence, plaintiffs, along with the General Counsel of the Securities and Exchange Commission ("SEC") and Bankers Trust, filed memoranda arguing over whether the sale by Bankers Trust of third party commercial paper violated certain provisions of the Banking Act of 1933 known as the Glass-Steagall Act. On June 28, 1979, after a meeting with representatives of Becker and SIA, the General Counsel of the Board issued a document entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis," which concluded that state member banks may, subject to certain limitations, sell third party commercial paper. The General Counsel offered, upon request by Becker or SIA, to recommend that the Board review his opinion. SIA, on July 26, 1979, and Becker, on January 31, 1980, requested that the Board review the General Counsel's opinion and that, in connection with that review, they initiate proceedings against Bankers Trust for violating the Glass-Steagall Act.[2]

> due, it is generally rolled over—that is, reissued—to the same or a different investor at the market rate at the time of maturity.

Id. at 363-64 (footnotes omitted).

2 Because it may affect the jurisdiction over this action, the parties dispute vigorously whether plaintiffs requested that the Board initiate cease and desist proceedings. Suffice it to quote from plaintiffs' precise language:

> This application is intended to . . . renew the SIA's request for formal action by the Board requiring Bankers Trust Company to cease and desist from its illegal activities. (Application of SIA for Review of State Member Bank Action, July 26, 1979 at 3; Record at

The Board took up the matter presented by the Becker and SIA petitions and, on September 26, 1980, issued a letter and a Statement Regarding Petitions to Initiate Enforcement Actions declaring that commercial paper was not a security within the meaning of the Glass-Steagall Act and that therefore Bankers Trust could legally sell third party commercial paper. The Board expressed concern at some potentially unsound practices that might have developed as a result of its ruling, and therefore commenced the drafting of guidelines governing the sale by state member banks of commercial paper.[3] Soon thereafter, the plaintiffs commenced this action seeking judicial review of the Board's conclusion that Bankers Trust was acting

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> 366) (Citations to the administrative record will be made as "R. at ___").
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> . . . Applicant SIA respectfully asserts that the Board should (1) formally review this matter, (2) Order Bankers Trust to cease and desist from its third party commercial paper activity . . . *Id.* at 20, R. at 383.
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> . . . this memorandum is submitted to urge the Board . . . to advise Bankers Trust that its current commercial paper marketing activities are inappropriate as a matter of law and policy, and should cease. (Memorandum on Behalf of A. G. Becker Incorporated to the Staff of the Board of Governors of the Federal Reserve System Concerning the Commercial Paper Activities of Bankers Trust Company, January 31, 1980 at 3, R. at 154) The advance of Bankers Trust into the commercial paper market exceeds the boundary of any fair interpretation of where Congress intended the line to be drawn. We respectfully urge the Board, in conformity with the provisions of the Glass-Steagall Act, to issue a declaration to that effect. *Id.* at 47, R. at 198.

The petition submitted by Becker on January 31, 1979, was referred to in their letter exactly one year later seeking review of the General Counsel's opinion.

3 These guidelines were issued in the context of a policy statement on May 28, 1981, effective immediately, to govern the sale of third party commercial paper by state member banks. The Board indicated that it would accept comments on the guidelines through July 31, 1981, and that it will monitor the activities of banks in the commercial paper market to permit modification or supplementation of the guidelines as experience suggests may be fruitful. Plaintiffs' challenge to the Board's action does not include an attack on these guidelines.

within the parameters of the Glass-Steagall Act in offering for sale third party commercial paper.[4]

Surfacing intially in this controversy is the question whether this court, or any court, has jurisdiction to hear this dispute and grant plaintiffs their requested relief. It is beyond dispute that agency action is reviewable absent a showing that Congress specifically and clearly intended to preclude judicial oversight. The Board in this case has the burden of demonstrating that its decision to permit state member banks to sell third party commercial paper is insulated from review. *See Dunlop* v. *Bachowski*, 421 U.S. 560, 567, 95 S. Ct. 1851, 1857, 44 L. Ed. 2d 377 (1975); *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970); *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 140 n.2, 87 S. Ct. 1507, 1511, 18 L. Ed. 2d 681 (1967). In *Independent Bankers Association of America* v. *Board of Governors of the Federal Reserve System*, 500 F.2d 812 (D.C. Cir. 1974), the Court of Appeals declared that "non-reviewability must be established by a clear showing

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4 Prior to the filing of this action challenging the substance of the Board's ruling, Becker sought relief in this Court for alleged violations by the Board of the Government in the Sunshine Act, 5 U.S.C. § 552b. On November 26, 1980, this Court issued a memorandum opinion containing a declaratory judgment that the defendants violated the Act's premeeting notice requirements but finding that in all other respects, the Board had acted lawfully. That decision, *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 502 F. Supp. 378 (D.D.C. 1980), *appeal docketed*, May 4, 1981, will be referred to as *Becker* I.

Additionally, Becker filed, concurrently with this action, a petition in the Court of Appeals for the District of Columbia Circuit, *A. G. Becker, Inc.* v. *Board of Govenors of the Federal Reserve System*, No. 80-2258 (D.C. Cir., filed Oct. 14, 1980), seeking review of the Board's determination that the sale by state member banks of third party commercial paper did not violate the Glass-Steagall Act. The actions were filed in both courts pursuant to the suggestion in the Court of Appeals that "[i]f any doubt as to the proper forum exists, careful counsel should file suit in both the court of appeals and the district court . . . ." *Investment Company Institute* v. *Board of Governors*, 551 F.2d 1270, 1280 (D.C. Cir. 1977). Becker's motion to stay its action in the Court of Appeals is pending.

of Congressional intent to preclude review." *Id.* at 814. Especially where an agency has resolved a pure question of law, which the Board did when it decided that commercial paper was not subject to the proscriptions of the Glass-Steagall Act,[5] courts have a special competence and judicial review is clearly the norm. *See Natural Resources Defense Council, Inc.* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1048 (D.C. Cir. 1979).

The Board contends that the availability of judicial review is governed by the Financial Institutions Supervisory Act of 1966, as amended, which established procedures for the issuance of cease and desist orders by federal agencies with authority over the banking industry. Alternatively, it maintains that its refusal to commence enforcement proceedings against Bankers Trust is a matter committed to its discretion by law and therefore nonreviewable under the Administrative Procedure Act. The plaintiffs strenuously reject that Congess has entrusted the Board with absolute discretion over this matter, suggesting that the Board's interpretation of the Glass-Steagall Act is subject to the normal presumption favoring judicial review absent a showing by the Board of clear deprivation of the Court's jurisdiction. Neither ground for nonreviewability cited by the Board, plaintiffs contend, overcomes the doctrine that permits courts to review agency decision on questions of law.

The Board's initial authority for its argument that jurisdiction lacks is the Financial Institutions Supervisory Act of 1966, as amended, specifically 12 U.S.C. §§ 1818(h), (i). This legislation established procedures for the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board to regulate the nations financial houses and to enforce against

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5 Even the Board recognized that its conclusions necessitated a resolution of a legal question. *See* Letter to plaintiffs' counsel, September 28, 1980 at 3, R. at 664 (". . . the issues involved in these petitions are primarily legal in nature . . . "); Statement Regarding Petitions to Initiate Enforcement Actions, September 28, 1980, at 28, R. at 692 (". . . the Glass-Steagall Act issues resolved by the Board are essentially legal in nature . . . ").

unsafe or unsound banking practices. It provides, in pertinent part:

> (h)(2) . . . any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order . . . by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit . . . a written petition praying that the order of the agency be modified, terminated, or set aside . . . .
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> . . .
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> (i)(1) The appropriate Federal banking agency may in its discretion apply to the United States district court . . . within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Under the Board's view, its decision not to institute cease and desist proceedings and its judgment that commercial paper is not a security under the Glass-Steagall Act are insulated from judicial scrutiny by these provisions. A decision not to adjudicate whether Bankers Trust's conduct was illegal is, in the Board's opinion, analogous to decisions by the Federal Trade Commission and the General Counsel of the National Labor Relations Board exercising their "prosecutorial discretion." *See Moog Industries, Inc.* v. *Federal Trade Commission*, 355 U.S. 411, 78 S. Ct. 377, 2 L. Ed. 2d 370 (1958); *Federal Trade Commission* v. *Klesner*, 280 U.S. 19, 46 S. Ct. 102, 70 L. Ed. 404 (1929) (both holding unreviewable a decision by the Federal Trade Commission not to institute cease and desist pro-

ceedings under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45) and *National Labor Relations Board* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 138, 95 S. Ct. 1504, 1510, 44 L. Ed. 2d 29 (1975); *Vaca* v. *Sipes*, 386 U.S. 171, 182, 87 S. Ct. 903, 912, 17 L.Ed. 2d 842 (1967) (holding unreviewable a decision of the General Counsel of the Board not to issue an unfair labor practice complaint). The Board also finds shelter for this position in the language of the statute quoted above, in that an injunction directing the Board begin a proceeding to prevent Bankers Trust to sell third party commercial paper would, of necessity, "affect" the issuance of a cease and desist order and thus contravene 12 U.S.C. § 1818(i)(1).

The Board, however, ignores the procedural posture of the proceedings before it and before this Court. 12 U.S.C. § 1818(i) is a narrow statute, applying only to an "order issued under this section." Section 1818 establishes a detailed procedure to govern efforts by the Board to enforce against unsafe and unsound practices. None of these procedures were followed in this case. The Act provides for proper notice, a hearing, service of the Board's findings upon the bank under investigation, and review of the Board's decision in a court of appeals. In this action, Becker and SIA submitted materials to the General Counsel, who issued a legal opinion on the meaning of the Glass-Steagall Act as applied to Bankers Trust's conduct. The General Counsel, while soliciting materials from Bankers Trust, held no formal hearing but rather worked with his staff to reach a resolution of plaintiffs' expressed concerns. He gave the plaintiffs the oportunity to request that he seek review of his own decision by the Board of Governors. Plaintiffs then sought from the Board of Governors a review of the General Counsel's legal opinion and, in connection with that review, the institution of enforcement proceedings. The Board agreed with its General Counsel and decided not to institute an adjudication against Bankers Trust. At this stage, where the plaintiffs are challenging the legal conclusion reached by the General Counsel and adopted by the Board, § 1818 does not proscribe review.

This analysis finds support in *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978). The appellate court held that jurisdiction did not vest in the district court to issue a declaratory judgment against the Comptroller, but explicitly found that "the Comptroller [had] set in motion cease and desist proceedings as authorized by 12 U.S.C. § 1818." *Id.* at 892. This is not an action such as *Groos* where "this regulatory process is not to be disturbed by untimely judicial intervention," *id.* at 895, because the administrative process here has reached a final conclusion that the Glass-Steagall Act is not violated when a state member bank sells commercial paper issued by unrelated corporations.

Moreover, it is a well recognized exception to statutes precluding judicial review that if an agency acts beyond the scope of its statutory authority, courts may exercise jurisdiction to overturn that administrative action. *See Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973) (decision of Comptroller of the Currency outside of its authority is reviewable notwithstanding § 1818). *See also Leedom* v. *Kyne*, 358 U.S. 184, 79 S. Ct. 180, 3 L. Ed. 2d 210 (1958) (action within discretion of National Labor Relations Board General Counsel is reviewable if he exceeds statutory authority).

Section 1818 does, however, preclude the Court from granting plaintiffs' prayer that an injunction be issued ordering that cease and desist proceedings be commenced against Bankers Trust. *See* Becker Complaint at 11, ¶ 6; SIA Complaint at 8, ¶ 5. It is beyond the jurisdiction of this court, and probably any court, to order the Board, by injunction, writ of mandamus, or otherwise, to begin cease and desist proceedings against a bank. Such a directive would surely intrude upon the limitation set out in § 1818(i)(1), that "no court shall have jurisdiction to affect by injunction or otherwise the issuance . . . of any notice or order under this section . . . ." It is clear, therefore, that the Court's power to grant relief in this action is limited to reviewing the legal conclusion reached by the Board concerning the meaning of the Glass-Steagall Act, and to issuing whatever declaratory order may be appropriate.

As a second and independent ground for its argument that the Court lacks jurisdiction, the Board maintains that its decision that Bankers Trust is not violating the Glass-Steagall Act is wholly within its discretion and therefore unreviewable. The Administrative Procedure Act deprives courts of jurisdiction where "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a)(2). The Supreme Court of the United States has interpreted this withdrawal of jurisdiction as predicated on a showing that nonreviewability must "fairly be inferred," from the regulatory framework, *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970), and that the statutes are drawn such that "there is no law to apply." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 410, 91 S. Ct. 814, 820, 28 L. Ed. 2d 136 (1971).

Whether a statute is drawn so broadly that there is no law to apply "turns on pragmatic considerations as to whether an agency determination is the proper subject of judicial review." *Natural Resources Defense Council* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1043 (D.C. Cir. 1979). In that decision, the Court of Appeals set out the proper focus of the inquiry:

> . . . we first identify as precisely as possible the aspects of the agency's action against which the challenge is brought. We then evaluate the relevance of three particularly important factors: the need for judicial supervision to safeguard the interests of the plaintiffs; the impact of review on the effectiveness of the agency in carrying out its congressionally assigned role; and the appropriateness of the issues raised for judicial review. Finally, we inquire whether the considerations in favor of nonreviewability thus identified are sufficiently compelling to rebut the strong presumption of judicial review.

Id. at 1044 (citations omitted).

The exact agency action under attack in this case is the Board's ruling that the Glass-Steagall Act is not violated when a state member bank sells third party commercial paper. The Board attempts to characterize its decision as based on more

than a purely legal analysis, but this is just not the case. Although the Board solicited materials from Bankers Trust on its activities, it chose expressly not to rely on this factual material. In the Board's statement it concluded,

> Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

R. At 688. Notwithstanding the Board's reliance on its special knowledge of the commercial paper market, once it decided not to address any factual matters underlying Bankers Trust's activity, it transformed the proceeding into a purely legal inquiry. Thus, the background of this dispute is materially different from that faced in *New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C.Cir. 1977), *cert. denied* 435 U.S. 942, 98 S.Ct. 1520, 55 L.Ed.2d 538 (1978), where the Court of Appeals decided to dismiss as unfit for review a petition seeking reversal of a decision of the Comptroller of the Currency that a specific automatic stock-investment plan did not violate the Glass-Steagall Act. In that case, the Court expressly noted that the Comptroller had assessed factual matters beyond a mere interpretation of the Act. But the Court was explicit as to how a pure legal question would be presented: "No doubt determining the general intent of Congress from the language and history of the Act is a matter of law. . . ." *Id.* at 741. A perusal of the Board's statements associated with its decision reveals that the Board resolved just a legal question in response to the Becker and SIA petitions. A weighing of the factors then set out in *Natural Resources Defense Council*, *supra*, leaves little doubt that the question presented is not only appropriate for review, but also demands judicial oversight in order to render a proper statutory interpretation.

Although the Board had discretion to make its legal decision, that discretion is neither absolute nor unreviewable. Rather, it represents the sort of administrative adjudication that has been held reviewable in the federal courts for "legal error, procedural defect or abuse." L. Jaffe, *Judicial Control of Administrative Action 362-63 (1965). See Nader* v. *Saxbe*, 497 F.2d 676, 679-80 n. 19 (D.C.Cir. 1974). In *Natural Resources Defense Council*, it was noted that the Administrative Procedure Act itself "command[s] an exacting judicial scrutiny" of agency determinations of "pure questions of law." 606 F.2d at 1048. *See* 5 U.S.C. §§ 706(2)(B),(C),(D). It is difficult to imagine an issue more suited to judicial review than the Board's determination; indeed, the Board's contentions on the merits of this litigation are predicated almost wholly on canons of statutory interpretation and an analysis of legislative history, which belie its claim that there is no law to apply. Moreover, the Board made no showing that review in this case would hamper its effectiveness in the future. It merely maintained that courts should not direct that a specific enforcement tool be chosen, and that the statute's lack of guidance as to when a cease and desist order is appropriate should be respected. Although it is true that § 1818 offers scant direction governing when the Board should institute cease and desist proceedings, whether the Board's legal conclusion is proper rests on inquiries familiar to all courts.

Further, the Board's suggestion that nonreviewability can fairly be inferred from the statutory framework is flawed. Defendants contend that § 1818(b)(1) suggests that courts should not interfere in actions such as this. That section provides that "[i]f in the opinion of the appropriate . . . agency, any insured bank" has violated the law or engaged in an unsafe practice, "the agency may issue" a notice of charges to initiate enforcement proceedings." This section neither expressly nor impliedly affects the review of purely legal determinations. It merely leaves the Board with discretion to decide when to initiate enforcement proceedings. The Board's characterization of its discretion sweeps too broadly, because it attempts to apply this narrowly drawn enactment to insulate

from review any ruling on a wholly legal issue as long as the decision is somehow related to the institution of enforcement actions.[6]

The parties' positions as to the exact nature of the Board's action are not entirely illuminating because, in one sense, they are all only partially accurate. The plaintiffs assert (and it would be difficult to contravene), that the Board issued a ruling on a question of law, *i.e.*, that state member banks, under the Glass-Steagall Act, could permissibly sell third party commercial paper. The Board correctly notes, though, that this decision was pronounced in the context of deciding whether to initiate cease and desist proceedings against Bankers Trust. Neither the judicial nor the administative processes provide for decisions on legal questions in a vacuum; each dispute is occasioned by factual developments that give rise to a particular problem. The difficulty courts face is in effectuating the delicate balance between the smooth exercise of administrative discretion in areas where agencies have expertise and the right of a party aggrieved with an administrative agency's interpretation of a legal question to seek judicial review.

The statutory scheme created in § 1818 precludes judicial interference in the enforcement processes until the appropriate stage, but nothing in § 1818, nor even in traditional canons of administrative law, prevents this Court from reviewing the propriety and correctness of the Board's legal determination that state member banks may sell third party commercial paper.[7] To hold that jurisdiction is absent here would be to vest

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6 The parties briefed and argued the question whether the Board's decision was ripe for resolution in this Court because, at the time the motions were filed, the Board had not issued the promised guidelines to guard against what it thought to be potential unsafe practices resulting from a state member bank's sale of third party commercial paper. When these guidelines were issued, however, *see n.* 3, *supra*, this issue evaporated from this controversy and hence will not be addressed.

7 This decision by the Board will undoubtedly have far reaching effect, much broader than merely permitting Bankers Trust to continue its commercial paper activity. The Board itself, as it issued guidelines

the Board with unreviewable discretion in any proceeding, limited only to facts presented, to resolve broad legal questions that are particularly within the competence of the courts to decide. Since the Court may not intrude into the congressionally sanctioned enforcement procedures set out in § 1818, and cannot therefore enjoin the Board to institute cease and desist proceedings, the Court's authority is restricted to resolution of the legal question presented and the grant of equitable relief consonant with that decision, within the bounds of appropriate judicial review.[8]

Before proceeding to consider the substance of the Board's conclusion, the parties vociferously dispute the degree of deference to be given the Board's expertise in the regulation of commercial banking in the United States. The Board suggests that its decision is immune from judicial alteration unless arbitrary, capricious, or wholly irrational. Plaintiffs contest this claim, pointing out that they challenge the Board's ruling on a legal question, reversal of which is mandated by the Administrative Procedure Act if not in accordance with the statute. 5 U.S.C. § 706.

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for all banks to follow, recognized that many banks were likely to adopt the route of Bankers Trust.

8 Although not raised by the parties, one final point on the jurisdictional issue warrants mention. In *Becker I*, the Court found that the Board's closure of its meetings on the petitions of *Becker* and *SIA* satisfied exemption 10 of the Sunshine Act, 5 U.S.C. § 552b(c)(10), which permits an agency to refuse to open a meeting concerning a decision to participate in adjudicatory proceedings, because the possibility of cease and desist proceedings was raised and discussed. That finding does not foreclose the determination that the matter on review at this time is the legal determination reached by the Board in conjunction with its decision not to initiate an action against Bankers Trust. The part of the Board's decision which rejected any enforcement proceeding against Bankers Trust is not subject to review, and to the extent that it was likely that proceedings against Bankers Trust might be discussed at the meetings, the Court remains convinced that the meetings were properly closed. That cease and desist proceedings may have been mentioned, however, does not assault the Court's authority to review the Board's resolution of the legal question at issue herein.

Amidst these opposing contentions the Court of Appeals has recently reaffirmed the Court's delicate role in deciding cases such as these:

> We are fully aware of the deference due the construction placed on a statute by an agency charged with the responsibility for administering it. . . . However, to accord deference is not to abdicate our duty to construe the statute, for the "courts are the final authorities and 'are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "

National Association of Recycling Industries, Inc. v. *Interstate Commerce Commission*, 660 F.2d 795 at 798-99 (D.C.Cir., 1981). Specifically with regard to federal banking legislation, the Supreme Court has recognized the expertise of the Board in interpreting and administering that statute. *See Board of Governors* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947). Nonetheless, the duty to examine the Board's rule to ensure its accordance with the law cannot be shirked. In *National Distributing Co.* v. *United States Treasury Department*, 626 F.2d 997 (D.C.Cir. 1980), the Court noted,

> This Court is vested by statute with the authority and responsibility to "decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action.". . . We are required to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . not in accordance with the law[.]"

Id. at 1019, *quoting* the Administrative Procedure Act, 5 U.S.C. § 706.

Some illumination of the statutory framework surrounding this litigation is appropriate. The Glass-Steagall Act was part of a package of banking reforms passed during the early part of the Presidency of Franklin Delano Roosevelt. Two of its sections are pertinent to this dispute:

Section 16 (12 U.S.C. § 24) Corporate Powers of Associations

Seventh. . . . The Business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the *association shall not underwrite any issue of securities or stock: Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association or corporation in the forms of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may be prescribed by the Comptroller of the Currency.

* * * * * * * *

Section 21 (12 U.S.C. § 378) Dealers in securities engaging in banking business; individuals or associations engaging in banking business; examinations and reports; penalties.

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, *engaged in the business of issuing, underwriting, selling or distributing*, at wholesale or retail, or through syndicate participation, *stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits* subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt. . . . (Emphasis added).

These provisions are made applicable to state member banks by 12 U.S.C. § 355.

The plaintiffs contend that the Board's decision contravenes the plain meaning of the Glass-Steagall Act because Bankers Trust, an institution in the business of receiving deposits, is, in their view, selling or underwriting commercial paper, which the plaintiffs argue is a security.

The first question to be addressed, then, is whether commercial paper is in fact a "note or other security" for purposes of the Glass-Steagall Act. In its statement asserting several legal bases for accepting the General Counsel's opinion, and in this litigation, the Board has attempted to justify its decision that commercial paper was not included in the Glass-Steagall Act. Section 21, the Board argues, was not intended to prohibit traditional banking functions, and the sale by Bankers Trust of third party commercial paper resembles other banking functions such as the sale of notes and bankers' acceptances to other lenders and the issuance of certificates of deposits. A decision that commercial paper is included within the Act's prohibition would, the Board suggests, jeopardize a host of traditional banking functions. Additionally, the Board analyzed the transaction involved in the sale of third party commercial paper and concluded that such activity resembled a loan, not a sale of securities. Although Congress did not, in 1933, specifically allude to commercial paper in the proceedings over Glass-Steagall, the Board points to indirect evidence that commercial paper was not intended to be included in the definition of "notes or other securities."

Plaintiffs maintain that the plain meaning of the Glass-Steagall Act prohibits exactly what Bankers Trust is doing, mixing the business of banking with the commerce of dealing in securities. The plaintiffs characterize the defendant's "parade of horribles" as irrelevant, because the traditional activities referred to by the Board are specifically permitted by other sections of the banking laws. In the plaintiffs' view what distinguishes Bankers Trust's conduct from other, more traditional banking functions, is the unique role of Bankers Trust, functioning between the issuer and the purchaser of commer-

cial paper. That role, the plaintiffs contend, is precisely what Congress intended to eliminate by its strict separation of investment banking from normal depository banking. Further, plaintiffs reject the Board's "functional anaylsis" that commercial paper is much like a loan, contending that the Board ignored the role of the bank in examining the transaction between the issuer of commercial paper and the purchaser. The plaintiffs also focus on the legislative history of the Glass-Steagall Act to support their position, citing, too, the Securities Act of 1933, which defines "securities" explicitly to include commercial paper. The Congress, plaintiffs proclaim, plainly sought to separate all dealing in speculative and other investments from the normal, more stable business of banking.

All statutory analysis begins with the recognition of an essential truth: "In any case concerning the interpretation of the statute, the 'starting point' must be the language of the statute itself, *Lewis* v. *United States*, 445 U.S. 55 [100 S.Ct. 915, 63 L.Ed.2d 198] (1980). . . ." *National Association of Recycling Industries, Inc.* v. *Interstate Commerce Commission*, 660 F.2d 795 at 799 (D.C.Cir. 1981). *See also Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). Also entrenched in statutory interpretation is the principle that where a statute is not ambiguous, the party attempting to avoid its plain language must offer "persuasive reasons" for concluding that Congress did not mean what it said. *Higgins* v. *Marshall*, 584 F.2d 1035, 1037 (D.C.Cir. 1978), *cert. denied*, 441 U.S. 931, 99 S.Ct. 2051, 60 L.Ed.2d 659 (1979). *See Tennessee Valley Authority* v. *Hill*, 437 U.S. 153, 98 S.Ct. 2279, 57 L.Ed. 117 (1978). The plain meaning of a statute may be avoided where there has been a significant change of circumstances since enactment or when a literal reading leads to an unreasonable or absurd result. *Consumers Union of the United States, Inc.* v. *Heimann*, 589 F.2d 531, 534 (D.C.Cir. 1978).

What does a "plain" reading of the Glass-Steagall Act then reveal? Defendants cannot and do not seriously dispute that commercial paper is a "note or other security" as mentioned in Section 21. The parties agree that commercial paper consists of

short-term, negotiable, usually prime quality and unsecured notes. That under a strict reading of the Act, commercial paper would be covered by Section 21 is bolstered by the Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed. 2d 367 (1971) (hereinafter *ICI I* or *Camp*) that "[t]here is nothing in the phrasing of either § 16 or § 21 that suggests the narrow reading of the word 'securities.' To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt." *Id.* at 635, 91 S.Ct. at 1101. Indeed, the statutes' unambiguous reference to "notes and *other* securities" surely indicates Congress's interpretation that the term "securities" encompassed "stocks, bonds, debentures and notes" in section 21. This meaning ascribed to section 21 applies with equal force to section 16, which does not mention "notes," but refers rather to "securities or stocks." *See Fortin* v. *Marshall*, 608 F.2d 525, 528 (1st Cir. 1979) (giving same words identical meanings in a single statute).

Does this strict interpretation of the Glass-Steagall Act lead to absurd and outrageous results? In the Board's view, many traditional commercial banking functions would simply grind to a halt were this Court to rule for plaintiffs, but their fears appear greatly exaggerated. Section 16 of the Glass-Steagall Act clearly recognizes that banks may discount and negotiate promissory notes as part of their traditional lending functions. Moreover, this Court is not presented with a broad-scale attempt by plaintiffs to reorganize the entire commercial banking industry. Rather, holding commercial paper to be included in the prohibition of the Glass-Steagall Act yields no great damage to the foundation of commercial banking. Whatever the Board decides to undertake as a result of the declaration herein is neither predicted nor directed, but when it recognizes that third-party commercial paper is a "note or other security," its mandate under the law will have been fulfilled.[9]

9 The Board decided that commercial paper was not an investment security and then swept to the conclusion that if the Court held that commercial paper was a note or security, banks would be completely

Reliance on the literal language of sections 16 and 21 is supported by the 1971 decision in *ICI I.* In *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 101 S.Ct. 973, 67 L.Ed.2d 36 (1981) (hereinafter "*ICI II*") Mr. Justice Stevens described the *Camp* decision:

> In *Camp* the Court *relied squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act.* After noting that § 16 prohibited the underwriting by a national bank of any issue of securities and the purchase for its own account of shares of stock of any corporation, and that § 21 prohibited corporations from both receiving deposits and engaging in issuing, underwriting, selling, or distributing securities, *the Court recognized that the statutory language plainly applied* to a bank's sale of redeemable and transferable "units of participation" in a common investment fund operated by the bank.

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precluded from purchasing commercial paper. This, the Board contends, is an absurd result justifying rejection of the plain statutory language. The Board's contention that commercial paper is not an investment security, however, is not persuasive.

Section 16 grants to the Comptroller of the Currency the discretion to classify some securities as investment securities to permit banks to purchase them for their own account. The Comptroller's regulations specify that an investment security is "a marketable obligation in the form of a bond, note, or debenture which is commonly regarded as an investment security" that is not "predominately speculative in nature." 12 C.F.R. § 1.3(b). The Bank points to the legislative history of the McFadden Act of 1927 where Congressman McFadden clearly states that commercial paper was not considered an investment security. *See* 67 Cong. Rec. 3232 (1926). Plaintiffs indicate, however, that the McFadden Act was eviscerated by the Glass-Steagall Act in that Congress rejected the notion that commercial banks could be engaged in the investment banking business, a premise recognized by the McFadden Act. Additionally, plaintiffs submitted a letter from the Chief National Bank Examiner, dated March 10, 1981, in a matter unrelated to this dispute, where it is held that what is a loan for one purpose may be a security for another. Becker Reply Mem., Exh. 3. Banks could, even in light of the Court's holding, continue to purchase commercial paper as they traditionally have, and plaintiffs' arguments do not appear inconsistent with the scheme of the Glass-Steagall Act.

Id., 101 S.Ct. at 986 (emphasis added). See generally Clark and Saunders, *Judicial Interpretation of Glass Steagall: The Need for Legislative Action*, 97 Banking L.J. 721 (1980) (noting that courts traditionally invoke a literal interpretation of the Glass-Steagall Act).

The broad framework of the Glass-Steagall Act demonstrates that Congress intended to pass a flat prohibition against any single type of institution—commercial or investment banking—from engaging in any of the badges incident to the others' enterprise. The statute draws broad lines, leaving no room for administrative amendment. It reflects "the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities." *Baker, Watts & Co.* v. *Saxon*, 261 F.Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968). Deemed a "drastic step," the Glass-Steagall Act prohibits "commercial banks, banks that receive deposits subject to repayment, lend money, discount and negotiate promissory notes and the like, from going into the investment banking business." *ICI I*, 401 U.S. at 629, 91 S.Ct. at 1098. The Act "was a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *Id.* at 639, 91 S.Ct. at 1103. The Court in *ICI I* further applied "as they were written" the Act's "literal terms" to overturn a decision of the Comptroller of the Currency to permit commercial banks to operate investment funds. *Id.*

This reading of the Glass-Steagall Act's framework is different from the Bank Holding Company Act of 1956, analyzed by the Supreme Court in *ICI II*. That statute authorizes the Board to determine whether a given activity is sufficiently related to banking to permit a nonbanking subsidiary of a bank holding company to engage therein. *See ICI II*, 450 U.S. at 73, 101 S.Ct. at 990. The Bank Holding Company Act clearly provides for the sort of discretionary decision made by the Board in this dispute, as it might be applied to a subsidiary of a bank holding company. But nowhere in the Glass-Steagall Act is the Board authorized, despite the plain language of the

statute, to permit a bank to engage in a particular activity because it does not pose risks to consumers or investors. Indeed, as the Court in *ICI I* recognized,

> From the perspective of competition, convenience, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards [of that choice] made necessary to prohibit this activity to commercial banks.

ICI I, 401 U.S. at 636, 91 S.Ct. at 1101. Indeed, with the exception of the delegation in Comptroller of the Currency to determine what is an "investment security," there are no lines to be drawn.

The parties delve into the legislative history of the Glass-Steagall Act, neither producing convincing evidence of how Congress might have answered the question posed by this case were it presented in 1933. Nowhere in the record of the Act do the drafters define whether commercial paper is a note or other security. The defendants suggest that the Congress recognized that transactions in commercial paper were part of traditional banking practices at the time the Act was passed, and not part of the speculative business that gave rise to the prohibitions contained in the Act. Indeed, Senator Glass, whose name the Act bears, proposed during a debate on the Securities Act of 1933 that short term notes, including "nine months' commercial paper," be excluded from the definition of security contained in that legislation because such a definition would "radically interfere" with "ordinary commercial banking transactions." *Securities Act: Hearings on S. 875 before the Senate Committee on Banking and Currency,* 73d Cong., 1st Sess. 98 (1933). Plaintiffs counter that although banks were traditionally large purchasers of commercial paper, their role as seller was limited to occasional transactions; indeed, Congress's rejection of Senator Glass's proposal demonstrates a view that commercial paper was considered a security. It is unnecessary to trace the historical development of the commercial paper market; rather, based on the undisputed facts, the

role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions. Congress's silence as to commercial paper specifically, combined with the general scheme of the Act, indicates that it did not contemplate adjustments in the definition of "notes or other securities" by the Board or any other agency in an administrative proceeding.

The parties energetically dispute whether the definition of security in the Securities Act of 1933, which includes "any note," 15 U.S.C. § 77b(1), affects the interpretation of the Glass-Steagall Act. Although short term notes such as commercial paper are exempt from the registration provisions of the Securities Act of 1933, the antifraud proscriptions still apply. *See* 15 U.S.C. §§ 77c(a)(3), 77l(2). Defendants contend that the statutes have such different general purposes that it would be unreasonable to impute the definition of security offered in one statute to another act. *United Shoe Workers of America* v. *Bedell*, 506 F.2d 174, 188 (D.C.Cir.1974). Although the Securities Act of 1933 and the Glass-Steagall Act take regulatory aim at different financial institutions and markets, they were passed within three weeks of each other and designed to remedy the then existing catastrophe in the nation's financial markets. This is surely compelling evidence that the two statutes should be interpreted similarly. The district court, eventually affirmed in *ICI I* declared, "It would be inconsistent to conclude that Congress did not intend to obtain the equivalent meaning for the term 'securities' as used in the Securities Act of 1933 when it used the same term in the Glass-Steagall Act which was enacted by the same Congress." *Investment Company Institute* v. *Camp*, 274 F.Supp. 624, 642-43 (D.D.C.1967) (footnote omitted), *rev'd* 420 F.2d 83 (D.C.Cir. 1969), *rev'd* 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971).

In an analogous decision, *United States* v. *American Building Maintenance Industries*, 422 U.S. 271, 95 S.Ct. 2150, 45 L.Ed.2d 177 (1975), the Supreme Court considered the phrase "in commerce" as it is used in the Federal Trade Commission Act and in the Clayton Act, and concluded that "since both sections were enacted by the 63d Congress, and both were

designed to deal with closely related aspects of the same problem—the protection of free and fair competition in the Nation's marketplaces," the statutes should be given similar interpretations. *Id.* at 277, 95 S.Ct. at 2155. Both the Glass-Steagall Act and the Securities Act were directed at curing the perceived rampant speculation by banks, securities dealers, and individuals prior to the Crash of 1929, such activity considered the chief cause of the Great Depression; their common goals suggest the relevance of the similar definitions.

The Board's final justification for its interpretation of the Glass-Steagall Act is its "functional analysis" of a commercial paper transaction which, in its view, compels the conclusion that commercial paper is more like a loan transaction than a security sale. The Board found that commercial paper, as short-term notes, functioned to provide corporations with cash and that banks, as traditional purchasers of commercial paper, effectively loaned such money to the issuers. *See* R. 682-84. The problem with the Board's analysis emerges instantaneously: it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account, *e.g.*, its trust department, or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. The Board's analysis would also sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks. The dispute over the Board's determination that commercial paper represents a loan reveals the problematic query presented in this challenge: when is a device to raise funds for a business a loan and when is it a security? One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and that crucial aspect is the role of Bankers Trust in the transactions.[10]

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10 The Court, like the Board, does not reach the question whether Bankers Trust was actually underwriting securities in violation of the Glass-Steagall Act. The question presented herein is whether the Board

This dispute is only the proverbial tip of the iceberg as to debates currently raging in the houses of Congress concerning the proper functions of commercial banks, especially in light of a more active "banking" role taken by securities' dealers. In its *amicus* memoranda, the Securities and Exchange Commission argues forcefully and persuasively that any alteration of the lines drawn by current banking statutes is for the popularly-elected Congress to undertake. Especially in light of these current efforts to reallocate the roles of depository and non-depository institutions, both the Court and the Board should refrain from unique and heretofore unprecedented interpretations of the 1933 Glass-Steagall Act which cast such a long shadow as does the Board's ruling on the Becker and SIA petitions. The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.[11]

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erred when it concluded that commercial paper was not a security under the Act. Although the Court has offered various characterizations to Bankers Trust's conduct, by no means does this opinion mean to convey that the bank was underwriting securities.

11 Becker contends that it was denied procedural due process by the Board in that the Board denied its request for a hearing or oral argument and refused to provide advance notice to Becker of the Board's meetings. The Court, in *Becker I* has already ruled on the open meeting aspect of the litigation, and Becker had no absolute right to present an oral argument. All of the written materials submitted were sufficient to permit the Board to deny oral argument without abusing its discretion. *Arthur Lipper Corp. v. Securities and Exchange Commission*, 547 F.2d 171, 182 n.8 (2d Cir. 1976), *cert denied*, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). Becker also argues that the Board received *ex parte* communications from Bankers Trust while it was deliberating on the Becker and SIA petitions. The Board proffers an affidavit of Rose L. Arnold, in charge of the Freedom of Information Office for the Board, who indicates that the material received from Bankers Trust was available for inspection in the public reading room of the Board. Its availability to Becker and to the public negates Becker's contention that this material (now a part of the administrative record, *see* R. at 476-550) was concealed or that the Board's receipt of such documents prejudiced Becker's rights.

A word need be added about the exact nature of the relief to be awarded plaintiffs. As previously noted, the law prohibits any court from affecting the issuance of a cease and desist order under 12 U.S.C. § 1818. The plaintiffs have indicated that the principal relief sought is a declaratory judgment that the Board's September 26, 1980 ruling that commercial paper is not a note or security under the Glass-Steagall Act is contrary to law. Such a judgment is within the province of this Court to award, and is attached herein. The Court expresses no opinion as to what steps, if any, may be taken following the issuance of this declaratory judgment.

Federal Reserve System

STATEMENT REGARDING PETITIONS
TO INITIATE ENFORCEMENT ACTION

The Securities Industry Association (the "SIA") and A.G. Becker, Incorporated ("A.G. Becker") have requested the Board to prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling commercial paper issued by companies not related to the bank ("third party commercial paper"). The SIA and A.G. Becker allege that Bankers Trust's sale of third party commercial paper violates the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. A.G. Becker also contends that considerations of public policy militate against permitting Bankers Trust from selling third party commercial paper.

Bankers Trusts' Sales Activities

Commercial paper refers to prime quality, negotiable, usually unsecured short-term promissory notes issued by business organizations to meet part of their short-term credit needs.[1] Commercial paper is offered and sold to sophisticated purchasers, rather than to the general public, through dealers or directly by the issuer. Because commercial paper is usually unsecured, issuers are generally large, well-known, and financially strong businesses. Most commercial paper has an initial maturity of 60 days or less and the paper sold by dealers is issued in denominations usually ranging from $100,000 to $1 million or more. Purchasers of commercial paper are mostly large institutions with idle short-term funds to invest. Commercial paper is considered relatively risk-free; interest rates on

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1 For a more detailed description of the commercial paper market *see* Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977) [hereinafter cited as "Hurley"] and Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

commercial paper are usually slightly above the rates on short-term United States government obligations, such as Treasury bills. The proceeds of commercial paper traditionally have been used for current or seasonal needs.

Bankers Trust represents that it is selling third party commercial paper only as the agent of the issuer and that the bank is not, like the commercial paper dealers, acting as a principal in such sales. Bankers Trust does not purchase, or make any commitment to purchase, the commercial paper the bank sells as agent. On some occasions, however, Bankers Trust extends credit (without any prior commitment), at or near the commercial paper rate, to issuers of paper sold by the bank in an amount representing a small portion of the unsold amount of the issue. The notes representing such loans may subsequently be sold. The bank's parent holding company has purchased for its own account commercial paper sold by the bank.[2]

Bankers Trust states that it does not tie the use of its other services to its commercial paper selling services and does not offer special inducements to issuers using such services. Bankers Trust sells only prime quality commercial paper of issuers that have the highest rating from at least one of the rating services that rate commercial paper issuers.

The customers to whom Bankers Trust sells commercial paper are usually part of Bankers Trust's established base of institutional investors that regularly purchase from the bank other short-term instruments in which the bank deals. Bankers Trust does not sell to individuals or to its trust department accounts.

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2 The bank also provides financial advice to issuers with regard to the issuance of commercial paper and serves as settlement agent for purchases of commercial paper. None of these activities has been directly challenged. Bankers Trust also sells as agent commercial paper issued by its own parent holding company. The Legal Division's analysis expressed no opinion on this activity and it is not involved in the present petitions.

The Glass-Steagall Act Issues

The Banking Act of 1933 contains four provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks in specified securities activities. The provisions involved here are sections 16 and 21 of the Act, the provisions that apply to banks.[3] Section 16 provides in relevant part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. 12 U.S.C. § 24 Seventh.

Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, provides that State member banks are subject to the limitations of section 16 with respect to dealing in securities.

Section 16 carves out an exception to the general prohibition against involvement with securities by providing that national banks (and consequently State member banks) may purchase for their own account "investment securities" as defined in the statute.[4] "Investment securities" are defined by section 16 generally as marketable debt obligations commonly known as investment securities under such further definition prescribed by the Comptroller of the Currency. The Comptroller's regula-

3 Section 20 of the Act, 12 U.S.C. § 377, prohibits affiliates of banks from "engaging principally in the issue, flotation, underwriting, public sale or distribution" of securities. In addition, section 32 of the Act prohibits member banks from having director, officer, or employee interlocks with companies "primarily engaged" in the securities business.

4 Section 16 makes a further distinction with respect to investment securities. Banks may *underwrite* and *deal in* (as well as purchase for their own account) certain kinds of investment securities: obligations of the United States, general obligations of states or political subdivisions of states, and obligations of or guaranteed by certain government agencies.

tion, 12 C.F.R. § 1.3(b), defines "investment security" as a marketable debt obligation "commonly regarded as an investment security" and not "predominantly speculative in nature."

Section 21 of the Glass-Steagall Act provides that it is unlawful

> For any person, or . . . organization, engaged in the business of issuing, underwriting, selling, or distributing, . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time . . . in the business of receiving deposits. 12 U.S.C. § 378(a)(1).

Section 21 further provides that its restrictions do not prohibit any bank from "dealing in, underwriting, purchasing, and selling investment securities, or issuing securities" to the extent such activities are permissible under section 16.

Thus, both section 16 and section 21 recognize a distinction between "investment securities" and other kinds of securities. Banks in general may invest in, *but not* underwrite or deal in (with limited exceptions), investment securities; banks are barred from issuing, purchasing for their own account, underwriting, or dealing in securities that do not qualify as investment securities.[5]

The contentions of the SIA and A.G. Becker that Bankers Trust is violating these statutory prescriptions are based on the contentions that (1) commercial paper is a "security" for purposes of the Glass-Steagall Act and (2) Bankers Trust's selling activities constitute the forbidden underwriting and dealing in securities. Additionally, the SIA and A.G. Becker claim that the selling of third party commercial paper gives rise to the kinds of abuses and hazards identified in the Supreme Court's 1971 analysis of the Act in *Investment Company Institute* v. *Camp*, 401 U.S. 617. The Securities and Exchange Commission ("SEC") has submitted to the Board the SEC's views on the issues raised by petitioners.

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[5] Under section 16, however, banks may perform certain *brokerage* activities—purchase or sale solely on the order of a customer—with respect to any securities.

A. *Commercial Paper as a "Security" under the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC advance three arguments in support of the claim that the commercial paper being sold by Bankers Trust is a "security" within the meaning of the Glass-Steagall Act: (1) commercial paper consists of marketable debt instruments and therefore constitutes an "investment security" as defined in section 16; (2) even if commercial paper is not an "investment security", commercial paper is a security because it consists of "notes" as specified in section 21; (3) commercial paper is a security for purposes of the Securities Act of 1933 and accordingly must be considered such for purposes of the Glass-Steagall Act, which was passed twenty days after the Securities Act.

Based on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a "security" within the intendment of the Glass-Steagall Act.

"*Investment securities*." In interpreting the meaning of the Glass-Steagall Act, the starting point must be the language of the statute itself.[6] Although each of the four Glass-Steagall Act provisions refers to activities with regard to "securities," none of these provisions, nor any other section of that Act, contains a precise definition of the term "securities." As noted above, however, both section 16 and section 21 create a distinction between investment securities—obligations that a member bank may purchase for its own account but in general may neither underwrite nor deal in—and other securities—obligations with which banks may have no involvement (except for permissible brokerage activities).

"Investment securities" are defined in section 16 as follows:

> *marketable obligations, evidencing indebtedness* of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures *commonly*

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6 *See, e.g., Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 16 (1979).

> *known as investment securities under such further definition* of the *term . . . as may by regulation be prescribed by the Comptroller of the Currency.* 12 U.S.C. § 24 Seventh (emphasis added).

The Comptroller's implementing regulation defines investment security as "a marketable obligation in the form of a bond, note, or debenture *which is commonly regarded as an investment security*" that is not "predominantly speculative in nature." 12 C.F.R. § 1.3(b). (emphasis added).

The statutory language and the implementing regulation are clear: not all non-speculative, marketable debt obligations are "investment securities"; only those obligations that are *commonly known* or *regarded* as such qualify.[7] Consequently, the statute directs that the question of whether commercial paper constitutes an investment security be resolved only by resort to the common understanding of the nature of commercial paper by Congress, the regulatory agencies, and the banking industry.

The "investment securities" provision in section 16 did not originate in the Glass-Steagall Act, but in the prior provisions of the McFadden Act of 1927.[8] One of the purposes of the McFadden Act was to clarify the authority of national banks to deal in securities. At the beginning of this century, State chartered banks and trust companies, pursuant to liberal State legislation, became involved in a wide variety of investment banking functions, including the underwriting of debt and equity securities. National banks responded by expanding their activities to include the purchasing and selling—and underwriting and dealing in—not only municipal bonds but corporate bonds and stocks as well. *See* U.S. Department of the Treasury, Public Policy Aspects of Bank Securities Activities, App. 3-5 (1975). While the Comptroller permitted national banks to deal

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7 The contentions of the SIA and A.G. Becker that commercial paper is an investment security *merely* because such paper consists of marketable debt obligations ignore this plain language of the statute and the implementing regulation.

8 Pub. L. No. 639, ch. 191, 44 Stat. 1224.

in corporate debt,[9] there was no clear statutory authority for such activities. *Id.* In 1924, the Comptroller recommended legislation expressly to authorize national bank purchase and sale of investment securities.[10] The McFadden legislation followed in 1927.

Section 2 of that Act provided that the "business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse" marketable debt obligations commonly known as investment securities.[11] 44 Stat. 1226. This language was intentionally framed as a reaffirmance of the existing authority of national banks with respect to investment securities rather than as an affirmative grant of new power. *See* H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). The legislative history, however, is clear that the authority codified or confirmed by the McFadden legislation with respect to investment securities did not apply to commercial paper. This is made plain by the remarks of Congressman McFadden, the sponsor of the legislation, during debate on the bill. Mr. McFadden indicated that commercial paper is not considered an investment security (and thus would not be subject to the restrictions of the Act) but is subject to the statutory limitations on loans to individual borrowers. 67 Cong. Rec. 3232 (1926).[12]

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9 The Comptroller, as well as the courts, strictly forbade, however, national bank involvement in underwriting and dealing in equity securities. *Id.*, at 2-3, 5.

10 Annual Report of the Comptroller of the Currency for 1924, at 12.

11 This power was, of course, later restricted somewhat by the Glass-Steagall legislation.

12 The relevant colloquy involving Congressman McFadden is as follows:

> Mr. WAINRIGHT. Let me ask the gentleman whether *commercial paper, as generally understood and accepted*, is regarded as *investment security*.
>
> Mr. McFADDEN. *No; it is not*. Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities. *Id.* (emphasis added).

The view of the framers of the McFadden Act that commercial paper should be treated as a loan rather than as a security is consistent with historical studies of the commercial paper market that indicate that banks purchased and sold commercial paper (and served as commercial paper dealers) pursuant to their lending functions long before commercial banks began expanding their activities into the underwriting of corporate bonds and other debt obligations after the Civil War, activities that were restricted by the McFadden legislation concerning investment securities and, six years later, by the Glass-Steagall Act. Thus, the commercial paper activities of commercial banks were viewed as an independent operation separate from the banking industry's subsequent involvement with investment securities.[13]

Furthermore, it has been the consistent and uniform practice of the bank regulatory agencies for almost 50 years to consider commercial paper as a loan, not as an investment security. For example, the Board took the view in 1933, in letters to the House Commerce Committee and the Senate Banking Committee commenting on the proposed securities legislation of

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13 *See generally* A. Greef, The Commercial Paper House in the United States (1938) [hereinafter cited as "Greef"]; N. Baxter, The Commercial-Paper Market (1964); M. Myers, The New York Money Market, Vol. I (1932). Greef found, for example, that before 1840 commercial banks in various parts of the country were purchasing and selling commercial paper and that dealings by banks in commercial paper could be traced back to the first commercial banks organized in the United States. Greef, *supra*, at 6-7, 15-18. Indeed, by 1900 commercial banks and savings banks purchased 95 per cent of the commercial paper sold, *id.*, at 96, and commercial paper was recognized as an important form of secondary reserves for the banking system. B. Beckhart, The New York Money Market, Vol. III 236-242 (1932). In addition to purchasing commercial paper as an investment, banks participated in the selling of such paper as dealers. Greef, *supra*, at 63, 403-405; R. Foulke, The Commercial Paper Market 108 (1931). In light of the longstanding and intimate relationship of banks with commercial paper, the views of the framer of the investment security legislation that commercial paper was not subject to its provisions are consistent with common banking practice at the time.

1933, that commercial paper, "short-time paper issued for . . . obtaining funds for current transactions" and purchased by banks and corporations with temporarily idle funds should not be considered an investment security. The Board stated that the proposed legislation was apparently intended to apply only to "investment securities, which are issued for . . . obtaining capital funds . . . and are purchased by persons for investment."[14]

Although the Comptroller of the Currency is delegated primary responsibility for fashioning a definition of the term, the Comptroller has never formally ruled on the status of commercial paper as an investment security for purposes of section 16. However, in a letter to a national bank in 1971, the Comptroller's Chief Counsel took the position that commercial paper represents a loan (subject to the statutory limits on loans) and does not constitute an investment security.[15]

The present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan, not as an investment security. The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan. In addition, the Federal Reserve's manual of examination procedures follows the same position. In sum, based on the views of the framers of the investment securities provisions of section 16, of the banking industry, and of the regulators, the Board believes that commercial paper has not been, and is

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14 The Board's letters are reprinted in the hearings on the securities legislation. *Federal Securities Act: Hearing on H.R. 4313 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-181 (1933); *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933).

15 Under an interpretation issued by the Comptroller, the statutory limits on loans to individual borrowers (12 U.S.C. § 84) are separate and distinct from the limit prescribed by section 16 of the Glass-Steagall Act on holding investment securities of a single issuer. 12 C.F.R. § 7.1180.

not, "commonly known" as an "investment security" and thus does not meet the statutory criteria for investment securities under section 16.

"Securities" other than "investment securities." Apart from the restrictions applicable to investment securities, sections 16 and 21 impose prohibitions with respect to securities in general. Section 16 generally prohibits dealing in "securities and stock." Section 21 states that depository institutions may not engage in the business of issuing or selling "stock, bonds, debentures, *notes* or other securities." (emphasis added). Since commercial paper conventionally consists of unsecured promissory notes, it may be argued that the term "notes" as used in section 21 is, under its usual meaning, broad enough to cover commercial paper. While the words in statutes should generally be interpreted in light of their ordinary meaning,[16] it is clear for a number of reasons that the term "notes" as used in section 21 should not be interpreted according to its literal sense. First, by its terms section 21 describes depository institutions (institutions that section 21 prohibits from issuing and selling "notes") as engaged in the business of receiving deposits evidenced by a "certificate of deposit or other evidence of debt"—instruments that themselves may be classified as "notes." Thus section 21 itself expressly permits banks to issue and sell certain kinds of notes—notes evidencing deposits. Second, the Glass-Steagall Act was plainly designed to keep banks from engaging in the investment banking business, not to prohibit banks from performing the traditional functions of banks.[17] Ordinary lending transactions are evidenced by notes

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16 *See, e.g., Perrin v. United States*, 444 U.S. 37, 42 (1979).

17 *See Investment Company Institute v. Camp*, 401 U.S. 617, 629 (1971) [hereinafter cited as "*ICI v. Camp*"]. Indeed the Supreme Court in the *Camp* case noted that commercial banks traditionally ". . . lend money, discount and negotiate promissory *notes* . . ." *Id.* (emphasis added). Indeed, if commercial paper were deemed to be a security other than an investment security, banks would be prohibited even from purchases of commercial paper for their own account, an activity that banks have long engaged in and continue to conduct. *See* Greef, *supra* note 13, at 96; Hurley, *supra* note 1, at 529.

and, in addition, banks commonly sell such notes to other lenders. It is evident that to view a note representing a bank loan as a security for Glass-Steagall Act purposes and, thus, the sale of such notes as an investment banking activity forbidden by the Act is completely at odds with the basic purpose of the Act. The rules of statutory interpretation do not require a literal reading of the term "notes" that would thwart the clear purpose of the Act and that leads to irrational results.[18]

Since the plain meaning of the statute cannot be dispositive of whether commercial paper is a security under the Glass-Steagall Act, it is appropriate to examine the history of the Act to attempt to resolve the question. It appears that Congress never adverted to bank involvement with commercial paper when it considered the Glass-Steagall legislation. There is, however, some indirect evidence that Congress did not view commercial paper, at least as the commercial paper market then existed, as the kind of obligation that would be subject to the Act. It is commonly agreed that the Glass-Steagall Act resulted from a number of specific abusive practices with respect to securities that had grown up in the banking industry. In particular, Congress was concerned about the risks and dangers to the banking system resulting from bank involvement with the "speculative operations" in securities characteristic of investment banking and with the practice of banks, begun in 1908, of establishing "security affiliates" that engaged, among other things, in underwriting bond and stock

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18 *See, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643 (1978). This approach has been taken by the courts in interpreting the definition of security in the securities acts, which generally define "security" to include "any note." The courts have not applied this language literally to bring all notes within the ambit of the securities laws but, on a variety of theories, have for the most part concluded that notes evidencing traditional lending transactions are not covered. *Exchange National Bank of Chicago* v. *Touche, Ross & Co.*, 544 F.2d 1126, 1131-1138 (2d Cir. 1976). *See generally United Housing Foundations, Inc.* v. *Forman*, 421 U.S. 837, 848-850 (1975).

issues. *ICI* v. *Camp*, *supra* note 17, 401 U.S. at 629-630, 632.[19] The Glass-Steagall bill was enacted only after extensive hearings on its provisions had been held in 1931 and 1932. Neither the Board nor the parties have been able to find any evidence of congressional concern about bank involvement with commercial paper. Morevoer, because at the time that the Glass-Steagall Act was being considered commercial banks purchased for their own account almost all of the commercial paper issued and commercial paper served as an important source of secondary reserves,[20] it may well be doubted that Congress could have been unaware of the extensive relationship then existing between the banking system and the commercial paper market.

Moreover, while there is no direct evidence in the legislative history of the Glass-Steagall Act on the status of commercial paper under the Act, there is evidence of contemporaneous statements by one of the draftsmen of the Act that commercial paper should not be considered a security. While the Glass-Steagall Act was pending before Congress in 1933, Congress was also considering the legislation that became the Securities Act of 1933. During Senate consideration of the securities bill, Senator Glass, the chief architect of the prohibitions against bank securities activities, proposed that short-term notes, including "9 months' commercial paper," be excluded from the definition of securities contained in that bill because to define such obligations as securities would "radically interfere" with "ordinary commercial banking transactions."[21] While Senator

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19 *See also Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131 (7th Cir.), *cert. denied*, 414 U.S. 1040 (1973); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968); *New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *rev'd on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

20 *See* note 13 *supra*.

21 *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933).

Glass's proposed amendment was eventually adopted only as an exemption from some of the substantive provisions of the Securities Act,[22] his statements concerning the need for such an amendment strongly suggest that one of the principal draftsmen of the Glass-Steagall Act viewed commercial paper as closely linked to "ordinary commercial banking transactions" and not as involving the speculative investment banking functions that the legislation he sponsored was intended to restrain.[23]

In the course of administering the Glass-Steagall Act over the years the Board has not applied the Glass-Steagall Act prohibitions to the activities of banking organizations with respect to commercial paper. As noted above in the discussion of investment securities, the Board has traditionally viewed commercial paper purchased for a bank's own account as a loan, not as a security, for purposes of call reports. Furthermore, in its 1973 interpretation of the Glass-Steagall Act with respect to the sale of thrift notes (small denomination unsecured notes sold more or less continuously) by bank holding companies, the Board, while not expressly finding that commercial paper is not a security, stated that the issuance of commercial paper by a bank holding company "is not an activity intended to be included within the scope of section 20 of the Glass-Steagall Act." 12 C.F.R. § 250.221.

In addition to a review of the legislative history and agency interpretation, it is also appropriate to consider the status of commercial paper under the Act in light of the purposes for

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22 The effect of this action by Congress is discussed below.

23 The SEC argues that the testimony of Senator Glass is not persuasive because the Securities Act was enacted *before* the Glass-Steagall Act. Thus, according to the SEC, Senator Glass, if he really believed commercial paper was not a security, would have attempted, after a broad definition of "security" was adopted in the Securities Act, to amend the Glass-Steagall Act to exclude commercial paper. However, this argument assumes, without any support, that Senator Glass viewed the Securities Act definitions as germane to the Glass-Steagall Act.

which the Act was passed—to separate commercial and investment banking. As noted above with respect to the definition of "notes", a broad generic or literal reading of the term "security" would likely encompass a number of instruments that banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress. However, it would seem that if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.

If such an approach is taken with respect to commercial paper, the Board believes that the stronger conclusion is that commercial paper currently being sold by Bankers Trust represents a financing transaction that is closer in function to commercial lending than to the sale of an investment. Historically, the dividing line between commercial and investment banking depended on whether short-term or long-term funds were being provided. As a short-term instrument, commercial paper fell on the commercial banking side of the line. Historical studies of the commercial paper market indicate that, as that market originated and developed, commercial paper was the functional equivalent of a bank loan. Commercial paper was used to raise funds for short-term needs and was sold almost exclusively to commercial banks.

It is clear, however, that the commercial paper market has changed somewhat in recent years. Most notably, commercial banks are no longer the predominant purchasers of commercial paper.[24] Nevertheless, the Board is of the opinion that, after a review of Bankers Trust's activities, the commercial paper currently being sold by the bank appears to evidence transactions that are more like commercial lending transactions than the sale of investments. First, the commercial paper sold

24 *E.g.*, Hurley, *supra* note 1, at 529.

by Bankers Trust, like commercial paper generally, is a short-term instrument. While it may no longer be said that the provision of short-term credit to business is exclusively the function of banks, short-term loans continue to be the principal activity of commercial banks.[25] In addition, a typical commercial loan transaction involves a borrower and a single lender or, in the case of a loan participation, a relatively small number of lenders, that regularly extend credit as part of a business. Likewise, the purchasers of the commercial paper sold by Bankers Trust are relatively few in number and purchase paper in denominations larger than an average investor might be expected to afford. Moreover, it appears that most of the purchasers of the paper are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis. These facts, in the Board's view, support the conclusion that the commercial paper currently being sold by Bankers Trust is more analogous to a commercial loan than to an investment. This view is consistent with the legislative history of the Glass-Steagall Act and the Board's general approach to commercial bank involvement with commercial paper. Accordingly, the Board believes that the stronger argument is that commercial paper should not be considered a security for the purposes of the Glass-Steagall Act.[26]

The Securities Act of 1933. The SIA, A.G. Becker, and the SEC argue that because commercial paper is a security for purposes of the Securities Act of 1933,[27] commercial paper

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25 While it is the practice of commercial paper issuers to reissue (roll over) paper at maturity, the purchasers of the paper, unlike the holders of bonds or other longer term instruments, have the legal right to demand payment at the original maturity date.

26 The Board's conclusion is limited to the obligations generally recognized as commercial paper: prime quality, negotiable, usually unsecured, promissory notes with maturities less than nine months that are exempt from the registration requirements of the Securities Act of 1933. The Board expresses no opinion with regard to the sale by a bank of third party obligations that do not meet these criteria.

27 Act of May 27, 1933, ch. 38, 48 Stat. 74.

must likewise be viewed as a "security" under the Glass-Steagall Act. Under section 2(1) of the Securities Act, 15 U.S.C. § 77b(1), the term "security" includes "any note." Section 3(a)(3) of that Act exempts from the registration and prospectus-delivery requirements of the Act any note the proceeds of which are used for current transactions and with a maturity of nine months or less. 15 U.S.C. § 77c(a)(3). Under sections 12(2) and 17(c), 15 U.S.C. §§ 77l(2), 77q(c), such short-term notes are not exempt from the antifraud prohibitions of that Act. Consequently, it is generally held that commercial paper is a security (albeit an exempt security) for purposes of the Securities Act.[28] The petitioners and the SEC contend that the Securities Act definition of "security" should be read into the Glass-Steagall Act because the two pieces of legislation address the same activities and were enacted within three weeks of each other in 1933.[29]

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28 *Franklin Savings Bank* v. *Levy*, 551 F.2d 521, 524 n.6 (2d Cir. 1977). With respect to the status of commercial paper under the other major federal securities law, the Securities Exchange Act, the question is not as clear. Unlike the 1933 Act, the 1934 Act expressly exempts commercial paper from that Act's *definition* of security. 15 U.S.C. § 78c(a)(10). The courts have not applied the exclusion literally, and courts have found that commercial paper is covered under the 1934 Act, at least where the particular commercial paper involved did not meet the criteria for exemption from registration under the 1933 Act, *e.g.*, the commercial paper was sold to the public. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1078-1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

29 Petitioners and the SEC rely on the legal analysis contained in a 1977 Board staff study of commercial bank private placements, which concluded that the definitions of "issue", "underwriter", and "distribution" in the Securities Act were "a compelling analogy" to the same terms employed in the Glass-Steagall Act. The Board has never formally reviewed the legal conclusions of the staff's private placement study. However, the private placement legal analysis does not necessarily contradict the position taken here. The private placement conclusions do not suggest that the definitions of the Securities Act are *conclusive*. In addition, the Board believes there is a distinction between definitions of activities carried on in the securities business and the definitions of a security, which are jurisdictional in nature and more closely linked to the purposes for which each Act was enacted.

While it seems clear that the definition of security in the Securities Act is relevant to a determination with regard to what instruments Congress thought were securities covered by the Glass-Steagall Act, it is the Board's opinion that the definition of security in the federal securities laws cannot be deemed conclusive for Glass-Steagall Act purposes. In the Board's view, this conclusion is supported by a number of arguments, but the most persuasive argument is that the definition of security under the Securities Act encompasses a variety of instruments that represent traditional banking functions and that to apply the prohibitions of the Glass-Steagall Act to such obligations would make illegal functions that clearly are properly part of the business of banking.[30] For example, a bankers' acceptance, like commercial paper, is a security under the Securities Act but exempt from registration. 15 U.S.C. §§ 77b(1), 77c(a)(3). However, commercial banks routinely purchase and sell bankers' acceptances and commercial banks (including Bankers Trust) serve as dealers in bankers' acceptances. Indeed, the Board determined as long ago as 1934 that bankers' acceptances were *not* securities under the Glass-Steagall Act.[31] To view the Securities Act definition of security as conclusive for Glass-Steagall purposes, as the securities industry representatives and the SEC suggest, would require that the traditional activities of commercial banks regarding bankers' acceptances be considered as the prohibited dealing in securities. This result is clearly contrary to the intent of the Glass-Steagall Act, which was not intended to restrict commercial banking functions. *ICI* v. *Camp*, *supra* note 17, at 629. In addition, although the courts are not unanimous, the

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30 It should also be noted that the Securities Act and the Glass-Steagall Act were not enacted to accomplish the same objectives. The Securities Act is an *investor* protection measure; the Glass-Steagall act is designed to protect *banks*, not investors. *Russell* v. *Continental Illinois National Bank & Trust Co.*, *supra*, note 19.

31 Letter, dated June 8, 1934, from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of New York.

securities laws have in some cases been held applicable to certificates of deposits issued by banks,[32] passbook savings accounts,[33] loan participations,[34] and bills of exchange.[35] Under the theory advanced by the SIA, A.G. Becker, and the SEC, banks would be prohibited from issuing,[36] selling, or dealing in each of these instruments on the grounds that doing so is the prohibited business of investment banking. The Board does not believe such contentions are consistent with the purpose of the Act.[37]

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32 *Garner* v. *Pearson*, 374 F. Supp. 591, 596 (M.D. Fla. 1974).

33 *SEC* v. *First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973).

34 *Lehigh Valley Trust Co.* v. *Central National Bank of Jacksonville*, 409 F.2d 989, 991-992 (5th Cir. 1969).

35 *MacAndrew & Forbes Co.* v. *American Barmag Corp.*, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,532 (D.S.C. 1972).

36 The SEC states that considering time deposits as securities under the Glass-Steagall Act would not disrupt the statutory scheme of that Act because the Act does not prohibit a bank from issuing its *own* securities—only dealing in or underwriting the securities issued by *others*. However, section 21 plainly prohibits banks from engaging in the business of "issuing" and "selling" securities and does not limit such securities to those of third parties. While Board staff has taken the position that a bank's occasional issuance of its own stock, bonds, or debentures (an activity essential to the viability of the organization) does not constitute being engaged "in the business" of issuing securities under section 21, it seems clear that banks issue and sell time deposits, bankers' acceptances, and similar instruments as a regular part of their "business" and, if such instruments are considered securities for Glass-Steagall Act purposes, banks would be prohibited by the Act from such activities.

37 The Board expresses no opinion regarding the legal status of the commercial paper sold by Bankers Trust under the Securities Act of 1933 or under any other law except the Glass-Steagall Act. It is noted, however, that commercial paper has been held to be a security for at least some purposes under the federal securities laws. *See* pages 20-21, *supra*.

Because of the historical involvement of the banking industry with commercial paper, the nature of the commercial paper currently sold by Bankers Trust, and the fact that commercial paper is exempt from the substantive obligations of the Securities Act of 1933 (except for the antifraud provisions), the Board concludes that, notwithstanding the status of commercial paper as an exempt security under the Securities Act, the stronger argument is that commercial paper is not a security for purposes of the Glass-Steagall Act.

B. *Bankers Trust's Activities as Dealing in or Underwriting Securities*

Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

C. *Policy Concerns Behind the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC also assert that the selling of commercial paper by Bankers Trust produces the same kinds of risks to the bank and potential for conflicts of interest that Congress intended to eliminate in enacting the Glass-Steagall Act. In its opinion on the Glass-Steagall Act in *ICI* v. *Camp*, *supra* note 17, the Supreme Court analyzed the scope of the Act in terms of specific "hazards" and "financial dangers" that Congress had in mind when banks engaged in activities prescribed by the Act. 401 U.S. at 630.

At the outset, the Board notes that since the stronger view is that commercial paper should not be considered a security for Glass-Steagall Act purposes, the sale of commercial paper by Bankers Trust is not prohibited by the specific terms of that Act. Accordingly, it does not appear necessary to examine the dangers that the Act was intended to eliminate.[38] Nevertheless,

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38 *See Aaron* v. *SEC*, 100 S. Ct. 1945, 1955 (1980).

the Board believes that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking.[39] Thus, the Board, in cooperation with the other federal bank regulatory agencies, has initiated the process of developing guidelines governing the sale of third party commercial paper by a commercial bank designed to prevent potential unsafe or unsound practices that could arise in such an activity. When these guidelines are developed and submitted to the Board for consideration, the Board will address in that proceeding the general issues raised by the allegations of petitioners and the SEC relating to potential undue risks to banks or conflicts of interest arising from this activity.

Public Policy Considerations

A.G. Becker advances a number of public policy considerations that it claims militate against permitting a commercial bank to sell third party commercial paper. A.G. Becker first asserts that a full-service commercial bank selling commercial paper enjoys unfair competitive advantages over nonbank sellers because banks would be able to offer a package of services to an issuer of commercial paper that the nonbank seller could not offer. A.G. Becker also cites the potential for predatory pricing, access as settlement agent to the customer lists of competing sellers, and the cut-off of credit to nonbank sellers of commercial paper.[40] The Board's review of Bankers Trust's current operations in selling commercial paper has not uncovered any evidence at this time of such alleged unfair competitive practices.

It is next claimed that persons classified as "brokers" under the Securities Exchange Act of 1934 are subject to a number of

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39 *See* 12 U.S.C. § 1818(b).

40 A.G. Becker claims that the asserted advantages constitute "unfair practices" by banks under section 18(f) of the Federal Trade Commission Act and the Board's Regulation AA. 12 C.F.R. § 227.

regulatory requirements designed to protect investors and that banks (which are exempt from the definition of broker in the Securities Exchange Act) are not subject to similar restrictions. However, since commercial paper is exempted from the definition of security in the Securities Exchange Act,[41] it would appear that a nonbank seller of commercial paper is not subject to the provisions of that Act if commercial paper is the only instrument sold. In any event, commercial banks are subject to certain investor protection requirements in connection with their securities transaction activities similar to those imposed on nonbank brokers. *E.g.*, C.F.R. § 208.8(k). Moreover, Bankers Trust sells commercial paper only to sophisticated institutional investors that would appear to be less in need of many of the safeguards designed to protect average investors.

Finally, A.G. Becker claims that if commercial banks become dominant in the commercial paper market, the resulting competition may reduce the efficiency of the securities industry and impair the capital-raising mechanism provided by that industry. Presently, however, Bankers Trust is by no means dominant in the commercial paper market and there is no available evidence of disruption of the capital markets as a result of Bankers Trust's activities. Accordingly, the Board believes that the policy considerations advanced by A.G. Becker do not at this time warrant prohibition of Bankers Trust's selling of third party commercial paper.

In summary, the Board has determined to deny the petitions of the SIA and A.G. Becker to the extent such petitions allege that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy. The Board is taking no action regarding petitioners' contentions of dangers to Bankers Trust and potential conflicts of interest and will consider these issues in the context of the Board's consideration of guidelines governing the sale of third party commercial paper by commercial banks.

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41 15 U.S.C. § 78c(a)(10).

Request for Oral Argument

Counsel for A.G. Becker has requested the opportunity to present oral argument to the Board when this matter is submitted to the Board for consideration. However, the Board as yet has initiated no agency proceedings in connection with Bankers Trust's commercial paper activities and A.G. Becker is not a party to any agency proceeding pending before the Board. The Board notes that counsel for A.G. Becker has met with the Board's staff on at least two occasions concerning the activities of Bankers Trust. Moreover, the Glass-Steagall Act issues resolved by the Board are essentially legal in nature and all the interested organizations have submitted extensive written arguments on these issues. In the Board's view, these written submissions adequately explain the issues involved and oral argument before the Board at this time would serve no useful purpose. Accordingly, the request by A.G. Becker for oral argument before the Board on this matter is denied.

Federal Reserve System

POLICY STATEMENT CONCERNING THE SALE OF THIRD PARTY COMMERCIAL PAPER BY STATE MEMBER BANKS

[Docket No. R-0360]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement

SUMMARY: Pursuant to its authority to restrain unsafe or unsound banking practices by State member banks, the Board of Governors of the Federal Reserve System adopts a policy statement setting forth guidelines governing the sale by a State member bank of commercial paper of issuers not related to the bank ("third party commercial paper"). The guidelines reflect the Board's judgment that certain practices may develop in the sale by a bank of third party commercial paper that may not be consistent with the principles of safe and sound banking. The guidelines concern the type and amount of commercial paper that should be sold, the kinds of records that should be maintained, and the purchasers to which such paper may be sold. The Board intends to monitor closely the activities of State member banks in this area and may modify or supplement this policy statement based on the Board's review of the experience of State member banks in conducting these activities.

EFFECTIVE DATE: May 26, 1981. Interested parties may submit comments on the policy statement that will be reviewed by the Board. Comments must be received on or before July 31, 1981.

ADDRESS: Comments should include reference to Docket No. R-0360 and should be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washing-

ton, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, (202) 452-2782, or Richard Ashton, Senior Counsel, Legal Division, (202) 452-3750, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTAL INFORMATION: On September 26, 1980, the Board took action with respect to the petitions of the Securities Industry Association (the "SIA") and of A.G. Becker Incorporated ("A.G. Becker") that the Board prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling third party commercial paper. The Board denied the petitions to the extent they alleged that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or should be prohibited by general considerations of public policy. The Board also stated that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, potential unsafe or unsound practices. The Board thus took no action on the petitions' allegations of dangers to Bankers Trust or potential conflicts of interest pending development of general supervisory guidelines designed to avoid potential unsafe or unsound practices in the sale of third party commercial paper by State member banks.

In developing the guidelines that are set forth in the following policy statement, the Board has consulted with the staffs of the other federal banking agencies and has considered the allegations of unsafe practices made by the SIA and A.G. Becker and the comments of the Securities and Exchange Commission.

With respect to the possibility that a bank's commercial paper selling activities may lead the bank into investing its funds in imprudent investments, the Board recognizes that a bank's selling activity may result in the purchase of some commercial paper with the bank's own funds. However, the Board notes that banks have traditionally been permitted to purchase commercial paper for their own account and such

purchases have been treated for supervisory purposes as commercial loans. In addition, since only large, well-known corporations with established credit ratings are able to market unsecured obligations, commercial paper is generally a low-risk instrument, even relative to some commercial loans.[1] Furthermore, the Board's guidelines provide that a bank should sell only prime quality paper and make a thorough credit analysis of each issuer and that all commercial paper sold by the bank should be fully supported by available lines of credit.[2] These guidelines would also minimize the danger that a bank selling commercial paper might be tempted to make unsound loans to an issuer which is encountering financial difficulties in order to protect the bank's reputation.

The SIA, A.G. Becker, and the SEC have also raised the possibility of loans by a selling bank to facilitate purchase of commercial paper being sold by the bank. However, because rates on commercial paper are usually lower than rates charged on bank loans, the use of borrowed funds to purchase commercial paper would be unprofitable and thus unlikely. Accordingly, there does not appear to be any practical substance to this concern.

Another potential hazard cited in connection with bank sales of commercial paper is the possibility that the bank's salesman's interest might impair its existing obligations to its customers and might consequently damage the bank's good will and reputation. In particular, it is claimed that bank depositors might suffer losses on paper purchased from the bank, that "the bank's reputation for prudence and restraint would be abused," that the bank would lose its ability to provide disinterested investment advice, and that the bank

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1 The Board notes that, at least on some occasions, significant losses have been suffered by commercial paper purchasers, for example, the 1970 collapse of Penn Central Transportation Company. However, banking functions, such as commercial lending, also involve some degree of risk and losses can and do occur.

2 A selling bank could only participate in the line of credit up to the amount of its legal lending limit.

might "unload" worthless commercial paper in its trust department.

Under the Board's guidelines, however, a bank may sell commercial paper only to financially sophisticated purchasers and may not advertise commercial paper for sale to the general public. Thus, there appears to be little likelihood that any but a small fraction of a bank's depositors would even consider purchasing commercial paper being sold by the bank. For the same reason, the potential for a bank abusing its reputation for "prudence and restraint" in selling commercial paper does not appear significant. Finally, with respect to potential inability to provide disinterested investment advice and "unloading" of worthless commercial paper in the bank's trust accounts, the guidelines provide that the bank should not sell commercial paper to fiduciary accounts over which the bank has investment discretion.

The Board intends to monitor closely the selling activities of Bankers Trust and any other State member bank that may initiate such services. Based on further experience in this area, the Board may modify or supplement these guidelines to assure that such activities are conducted in accordance with principles of safe and sound banking.

Accordingly, acting pursuant to its supervisory authority over State member banks contained in section 9 (12 U.S.C. 321, *et seq.*) and section 11 (12 U.S.C. 248) of the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818(b)) and related provisions of law, the Board of Governors adopts the following policy statement.

Policy Statement Concerning Sale of Third Party Commercial Paper by State Member Banks

The Board of Governors has recently determined that the sale of commercial paper by a State member bank for unaffiliated issuers ("third party commercial paper")[3] did not violate

[3] Excluding commercial paper issued by a parent bank holding company; the Board has previously advised bank holding companies concerning sales of bank holding company commercial paper (letter dated June 27, 1980).

the Glass-Steagall Act (12 U.S.C. §§ 24, Seventh, 378). The Board was concerned however, that the sale of third party commercial paper[4] might, in some circumstances, involve unsafe or unsound practices. Accordingly, in the interest of safe and sound banking, the Board believes that any State member bank that may decide to engage in the sale of third party commercial paper should adhere to the following guidelines.[5]

1. A State member bank should sell only prime quality commercial paper that qualifies for the exemption provided by section 3(a)(3) of the Securities Act of 1933 (15 U.S.C. 77c(a)(3)). The bank should take appropriate precaution to assure itself that the section 3(a)(3) exemption applies to the commercial paper it proposes to sell. In this regard, (i) the bank should determine that the commercial paper it proposes to sell is of prime quality; (ii) the bank may rely on representations of the issuer with respect to the use of proceeds; (iii) except as further limited by paragraphs 7 and 8, the bank should sell commercial paper only to financially sophisticated customers, such as customers that regularly purchase a variety of short-term credit instruments, and should not advertise commercial paper for sale to the general public; (iv) the bank should obtain periodically, and maintain in the bank's records, a current legal opinion of counsel that the section 3(a)(3) exemption is available. In addition, the bank should sell commercial paper in minimum denominations that are consistent with applicable law and, in no event, should sell commercial paper in minimum denominations of less than $100,000.

2. The selling bank should maintain a complete credit analysis of the issuer at all times and should exercise due diligence

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4 Banks have traditionally purchased commercial paper upon the order, and for the account of, customers, whereas here the bank is essentially acting for the issuer; the former activity is not subject to the guidelines set forth in this Policy Statement.

5 The Board does not expect to take enforcement action to restrain unsafe or unsound banking practices with respect to third-party commercial paper selling activities of any State member bank that conducts such activities within these guidelines.

in investigating the financial affairs of the issuer. Particular attention should be given to the liquidity position of the issuer and its lines of credit. All commercial paper sold by the bank should be fully supported by available lines of credit. Any participation by the selling bank in such lines of credit should be made only after consideration of the bank's legal lending limit.

3. Senior management should adopt internal limits for the amount(s) of commercial paper that may be sold by the bank for a single or related issuer(s). In determining the internal limits, senior management should consider the financial condition of the issuer, all lines of credit available to the issuer, and the bank's participation in the lines of credit and any other extensions of credit or commitments to the issuer by the bank (including commercial paper purchased by the bank for its own account.)

4. Chronological records of original entry should be maintained that contain an itemized daily record of all sales and purchases of commercial paper. The records should also contain:

- A designation of the commercial paper,
- nature of the transaction, *e.g.* purchase or sale,
- trade and settlement dates,
- contra-party name or designation,
- net proceeds, discount rate, or yield to maturity.

5. Account records should be maintained for each issuer that reflect:

- All sales and purchases of commercial paper placed by the bank for that issuer,
- all lines of credit available to the issuer,
- the amount of the bank's participation in the lines of credit,
- a current balance of all extensions of credit and a description of other commitments to the issuer.

6. Account records should be maintained for each purchaser that reflect all sales and purchases of commercial paper for the account of that customer.

7. Commercial paper should not be sold to fiduciary accounts over which the bank has investment discretion.

8. Commercial paper should not be sold to the bank's parent holding company (unless it is a bank) or any nonbank affiliate of the bank.

9. The bank should furnish to all purchasers of commercial paper written advice in connection with all purchases that (1) the commercial paper is not an obligation of the bank, and is not insured by the FDIC, (2) the bank has no obligation to repurchase any of the paper sold, (3) the bank is under no obligation to lend funds to the issuer (except pursuant to existing credit lines, or other commitments, if any), and (4) copies of the issuer's most recently published financial statements will be furnished upon request.

By order of the Board of Governors, May 26, 1981.

(signed) James McAfee

James McAfee
Assistant Secretary of the Board

(SEAL)

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-1493, 81-2070, 81-2096,
80-2314 and 81-2058

February 2, 1983

A.G. BECKER INCORPORATED,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

Before:

TAMM and WILKEY, *Circuit Judges*,
and ROBB, *Senior Circuit Judge*.

ORDER

On consideration of the joint petition for rehearing of A.G. Becker, Inc. and the Securities Industry Association, filed December 17, 1982, it is

ORDERED by the Court that the aforesaid petition is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner
Chief Deputy Clerk

Senior Circuit Judge Robb did not participate in the foregoing order.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-1493, 81-2070, 81-2096,
80-2314 and 81-2058

February 2, 1983

A.G. BECKER INCORPORATED,
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—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.,
Respondents.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.,
Respondents.

Before:

ROBINSON, *Chief Judge*, WRIGHT, TAMM,
MACKINNON, WILKEY, WALD, MIKVA, EDWARDS, GINSBURG,
BORK and SCALIA, *Circuit Judges*.

ORDER

The joint suggestion for rehearing *en banc* of A.G. Becker, Inc. and the Securities Industry Association has been circulated to the full Court. A majority of the Court has not voted in favor thereof. On consideration of the foregoing, it is

ORDERED by the Court *en banc* that the aforesaid suggestion is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner

Circuit Judges MacKinnon and Mikva would grant the suggestion for rehearing *en banc*.

Chief Judge Robinson and Circuit Judges Wald, Ginsburg and Bork did not participate in the foregoing order.

Harvey L. Pitt
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A.G. Becker Incorporated

Of Counsel:

Steven M. Looney
General Counsel
A.G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
1737 H Street, N.W.
Washington, D.C. 20006
(202) 331-7760
Attorneys for Petitioner Securities Industry Association

Of Counsel:

William J. Fitzpatrick
Securities Industry
Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry
Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

A. G. BECKER INCORPORATED,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT APPENDIX

[Counsel listed on inside cover]

PETITION FOR CERTIORARI FILED APRIL 29, 1983
CERTIORARI GRANTED OCTOBER 3, 1983

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
1737 H Street, N.W.
Washington, D.C. 20006
(202) 331-7760
Attorneys for Petitioner Securities Industry Association

Of Counsel:

Steven M. Looney
General Counsel
A. G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

Harvey L. Pitt
(Counsel of Record)
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS, SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A. G. Becker Incorporated

Of Counsel:

Michael Bradfield
General Counsel
Richard M. Ashton
Assistant General Counsel
Board of Governors of the Federal Reserve System
Washington, D.C. 20551
(202) 452-3750

Rex E. Lee
Solicitor General
J. Paul McGrath
Assistant Attorney General
Anthony J. Steinmeyer
Attorney
Department of Justice
Washington, D.C. 20530
(202) 633-2217
Attorneys for Respondents Board of Governors of the Federal Reserve System, et al.

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RELEVANT DOCKET ENTRIES

Docket Entries in District Court, Civil Action No. 80-2614

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. No. 80-2614

A. G. BECKER INCORPORATED,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

CAUSE

28 USC, 1331, 1332 and 1337. Action seeks a declaratory judgment that the defts. violated their statutory duty to administer, enforce & regulate the nation's banking system, etc.

ATTORNEYS

Harvey L. Pitt
Suite 1000
600 New Hampshire Ave., N.W. 20037
342-3500
Attorneys for Plaintiff

Richard M. Ashton
Board of Governors of the Federal Reserve System
Washington, D.C. 20551
452-3750
Attorney for Defendants

DATE	*PROCEEDINGS*
1980	
Oct. 14	COMPLAINT: Exh. A; appearance
Oct. 14	SUMMONS (10) and copies (10) of complaint issued
Oct. 14	REQUEST by pltf. for appointment of special process server and ORDER by the Clerk appointing Mary Pelletter-Holzheimer to serve summons and complaint upon all defts.
Oct. 17	AFFIDAVIT OF SERVICE by Special Process Server Mary B. Pelletter-Holzheimer upon defts, #1 thru #8 on 10-14-80.
Dec. 11	MOTION by defts. for enlargement of time to answer or otherwise plead.
Dec. 16	ORDER filed 12-12-80 extending time to & including 1-5-81 for deft. to respond to the complaint. (N) JOYCE HENS GREEN, J.
Dec. 31	MOTION by defts. for enlargement of time in which to answer.
1981	
Jan. 9	ORDER filed 1-6-81 extending time to and including 1-19-81 for deft. to respond to complaint. (N) JOYCE HENS GREEN, J.
Jan. 12	NOTICE of defts. of filing certified copy of the administrative record; Administrative Record, Vol. I, Vol. 2.
Jan. 19	MOTION of defts. to dismiss or, in the alternative, for summary judgment, statement of material facts as to which there is no genuine issue, attachment, table of contents, table of authorities, exhibit A.
Jan. 19	MOTION of defts. to consolidate actions, memorandum of P&A, CA 80-2614 & CA 80-2730.

Docket Entries

DATE	*PROCEEDINGS*
Jan. 30	MOTION by pltf. for enlargement of time to respond to defts. motion to dismiss, memorandum of P&A.
Feb. 06	ORDER filed 2-4-81 that any motion to appear as amicus curiae be filed, accompanied with memorandum on the merits of this action within 10 days; pltf's reply to deft's motion to dismiss or for summary judgment no later than 2-27-81; There shall be no extensions. (N) JOYCE H. GREEN, J.
Feb. 10	ORDER filed 2-6-81 consolidating case with CA 80-2730 for hearing & trial of all matters. (N) JOYCE H. GREEN, J.
Feb. 12	MOTION of Securities & Exchange Commission for leave to file a memorandum of P&A Amicus Curiae, with respect to the defts' motion to dismiss or, in the alternative, for summary judgment and suggestion that the Court dispose of procedural issues before requiring briefs amicus curiae on the merits.
Feb. 17	MOTION by Goldman, Sachs & Co. for leave to file brief amicus curiae; Exhibit .
Feb. 23	ORDER filed 2-19-81 granting motion of Goldman, Sachs & Co. for leave to file brief amicus curiae. (N) GREEN, JOYCE HENS, J.
Feb. 23	MEMORANDUM of P&A's of Goldman, Sachs & Co. as Amicus Curiae in support of motion for summary judgment of pltf. Securities Industry Association, attachment.
Feb. 23	MEMORANDUM of Securities Industry Association in opposition to motion of Bankers Trust Co. for leave to appear as Amicus Curiae and to file a memorandum of law, exhibits A & B.

DATE	*PROCEEDINGS*
Feb. 27	REPLY by Bankers Trust Co. as amicus curiae to memorandum of Securities Industry Association in opposition to motion of Bankers Trust Co. for leave to appear as amicus curiae & to file a memorandum of law, table of authorities.
Feb. 27	CROSS-MOTION by pltf. Securities Industry Association for summary judgment, statement of material facts, memorandum of P&A, table of contents, table of authorities, addendum.
Feb. 27	CROSS-MOTION by pltf. A.G. Becker, Inc. for summary judgment, memorandum of P&A, table of contents, appendix, statement of material facts as to which there is no genuine issue, affidavit of Thomas R. York, statement of material facts as to which there exists a genuine issue.
Feb. 27	MEMORANDUM by pltf. A.G. Becker, Inc. of P&A's in opposition to defts' motion to dismiss or, in the alternative, for summary judgment, table of contents, table of authorities.
Mar. 04	MEMORANDUM (corrected version) by pltf. of P&A's in support of pltf's cross-motion for summary judgment, table of contents, table of authorities, appendix.
Mar. 04	MEMORANDUM of pltf. (corrected version) of P&A's in opposition to defts' motion to dismiss or, in the alternative, for summary judgment, table of contents, table of authorities.
Mar. 04	ERRATA SHEET by pltf. to memorandum of P&A's of pltf's cross-motion for summary judgment.
Mar. 09	ORDER filed 3-5-81 granting motion of Securities & Exchange Comm. to appear Amicus Curiae and

DATE	*PROCEEDINGS*
	allowing them to file memorandum re: motion of defts. to dismiss or for summary judgment; granting motion of Bankers Trust Company to appear as Amicus Curiae and accepting for filing Exhibit A. (N) JOYCE HENS GREEN, J.
Mar. 12	MOTION of defts. for enlargement of time to file a statement of P&A's in opposition to the cross-motions for summary judgment.
Mar. 17	ORDER filed 3-16-81 granting motion of defts. for enlargement of time until 4-21-81 to oppose pltf's cross-motion for summary judgment. (N) JOYCE H. GREEN, J.
Apr. 21	REPLY by defts. in support of defts' motion to dismiss or, in the alternative, for summary judgment, & opposition to pltfs. cross-motions for summary judgment, table of contents, table of authorities, exhibit 1, exhibit A, opposition to pltf. A.G. Becker Inc.'s statement of material facts as to which there is no genuine issue and opposition to pltf. Security Industry Assn.'s statement of material facts as to which there is no genuine issue.
Apr. 21	MEMORANDUM by Bankers Trust Co. of law as amicus curiae in opposition to pltfs' cross-motions for summary judgment & in further support of defts' motion to dismiss or, in the alternative, for summary judgment, table of contents, table of authorities, exhibit 1.
Apr. 23	MEMORANDUM BY PLTF. in opposition to motion of William Leighton for joinder as a party.
Apr. 23	OPPOSITION by defts. to motion for joinder of William Leighton, doing business as Option Advisory Service, Inc.

Docket Entries

DATE	*PROCEEDINGS*
May 08	REPLY MEMORANDUM by pltf. Securities Industry Association in opposition to defts' motion to dismiss, or for summary judgment & in support of its cross-motion for summary judgment, table of contents, table of authorities, exhibit.
May 08	REPLY BRIEF of amicus curiae Goldman, Sachs & Co.
May 12	MEMORANDUM by Securities & Exchange Commission as amicus curiae of P&A's, index, table of citations.
May 29	NOTICE by defts. of filing copies of a Policy Statement, attachment.
June 8	MEMORANDUM OF LAW by Amicus Curiae in opposition to the memorandum of Securities & Exchange Commission & in further support of defts' motion to dismiss or, in the alternative, for summary judgment, table of contents, table of authorities.
June 8	REPLY by defts. to memorandum of P&A's of the Securities & Exchange as amicus curiae.
June 12	RESPONSE by pltf. to defts' reply in support of defts' motion to dismiss or, in the alternative, for summary judgment, and opposition to pltfs. cross motions for summary judgment, table of contents, table of authorities, exhibits #1,2 & 3.
June 15	LETTER filed 6-12-81 dated 5-18-81 from Erick D. Roiter to Judge Green; corrected pages to P&A's of Commission (fiat) JOYCE H. GREEN, J.
Jun 18	MOTION of deft. to dismiss or for summary judgment and Motion of pltf. for summary judgment

DATE	PROCEEDINGS
	argued and taken under advisement. (Rep: Bud Abramowitz) GREEN, J. JOYCE
July 29	ORDER filed 7-28-81 denying motion to William Leighton d/b/a Option Advisory Services to be joined as a party. (N) GREEN, JOYCE HENS, J.
July 29	MEMORANDUM OPINION filed 7-28-81. (N) GREEN, JOYCE HENS, J.
July 29	ORDER and judgment filed 7-28-81 for pltfs. A.G. Becker, Inc. and the Securities Industry Association and against defts. Board of Governors of the Federal Reserve System, Paul A. Volcker, Frederick H. Schultz, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmett J. Rice and Lyle E. Gramley. (N) (See Order for details). GREEN, JOYCE HENS, J.
July 31	TRANSCRIPT of PROCEEDINGS, June 18, 1981; Rep: Barnet I. Abramowitz; Court Copy.
Sept 04	LETTER dated 8-21-81 from William Leighton, d/b/a Option Advisors Service, Inc. to Judge Green, "Let this be filed." (fiat) Joyce H. Green, J.
Sept 04	ORDER denying motion of William Leighton for relief from the Court's order of 7-28-81 denying movant joinder. (signed 9-3-81) (N) JOYCE H. GREEN, J.
Sep. 24	NOTICE OF APPEAL by William Leighton, d/b/a Option Advisory Services from order filed 7-28-81; \$65.00 docketing fee and \$5.00 filing fee paid & credited to U.S.; copies sent to Harvey L. Pitt, Richard M. Ashton.

Docket Entries

DATE	*PROCEEDINGS*
Oct. 01	COPIES of Notice of Appeal & docket entries transmitted to USCA. USCA# 81-2069.
Sep. 25	NOTICE OF APPEAL by defts. from order filed 7-28-81; No Fee-Govt.; copy sent to Harvey L. Pitt.
Oct. 01	COPIES of Notice of Appeal & docket entries transmitted to USCA. USCA# 81-2070.
Oct. 09	NOTICE OF CROSS APPEAL by pltf. from final judgment of 7-28-81; $65.00 docketing fee & $5.00 filing fee paid & credited to U.S.; copy sent to Richard M. Ashton and William H. Briggs, Jr., John W. Barnum, G. Duane Vieth, Edward G. Greene & John M. Lifton.
Oct. 09	COPIES of Cross Appeal & docket entries transmitted to USCA. USCA# 81-2096.
Nov. 17	RECORD ON APPEAL delivered to USCA, receipt acknowledged.
Dec. 28	COPY of Letter filed 12-22-81, dated 12-14-81 from William Leighton. (fiat) JOYCE GREEN, J. (orig. filed in CA 80-2730)
Dec. 28	COPY of Order filed 12-22-81 treating letter of 12-14-81 as motion to supplement record on appeal and granting said motion. (N) (orig. filed in CA 80-2730) JOYCE GREEN, J.
Dec. 28	COPY of Supplement to Record on Appeal filed 12-22-81. (orig. filed in CA 80-2730) JOYCE GREEN, J.
Dec. 29	SUPPLEMENTAL RECORD delivered. Receipt acknowledged.

Docket Entries in District Court,
Civil Action No. 80-2730

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,
Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL
RESERVE SYSTEM, et al.,
Defendant.

CAUSE

DECLARATORY JUDGMENT AND INJUNCTIVE
AND OTHER RELIEF
(12 U.S.C. 21 et seq.)

ATTORNEYS

John M. Liftin
1666 K St., N.W.
Washington, D.C. 20006
202-331-7766
Attorney for Plaintiff

Richard M. Ashton
Board of Governors of
the Federal Reserve System
Washington, D.C. 20551
452-3750
Attorney for Defendant

Docket Entries

DATE	*PROCEEDINGS*
1980	
Oct. 24	COMPLAINT, appearance.
Oct. 24	REQUEST for order appointing special process server and order appointing Max L.C. Ratibor to serve summons and complaint on U.S. Attorney.
Oct. 24	SUMMONS (10) and copies (10) of complt. issued.
Oct. 29	NOTICE by defts. of related case (C.A. 80-2614).
Nov. 4	REASSIGNMENT of case from Judge Flannery to Judge Joyce Green.
Nov. 18	AFFIDAVIT of service (10) of service of summons and complaint on defts., Board of Governors of the Federal Reserve System, Benjamin R. Civiletti, Lyle E. Gramley, J. Charles Partee, Emmet J. Rice, Frederick H. Schultz, Nancy H. Teeters, Paul A. Volcker and Henry C. Wallich by certified mail; attachments.
Nov. 18	AFFIDAVIT of service of summons and complaint by special process server of service on M. Saulene Brown on 10/24/80.
Dec. 23	MOTION of defts. for enlargement of time to answer.
Dec. 31	MOTION of defts. for enlargement of time.
1981	
Jan. 6	ORDER extending time until and including 1/19/81 for deft. to answer. (N) GREEN, JOYCE J.
Jan. 12	NOTICE of filing by deft.; Administrative Record (2 Vols).
Jan. 19	MOTION of defts. to dismiss or, in the alternative, for summary judgment; statement of material facts; attachments; P&A's; Exhibit A.

Docket Entries

DATE	*PROCEEDINGS*
Jan. 19	MOTION of defts. to consolidate actions; P&A's.
Jan. 30	MOTION of Plif. for enlargement of time and setting of briefing schedule; memorandum.
Feb. 4	ORDER that motions to appear amicus curiae be filed accompanied with memorandum on the merits within 10 days; pltf's reply to motion to dismiss or for summary judgment to be filed no later than 2/27/81; there shall be no extensions. (N) GREEN, JOYCE J.
Feb. 9	ORDER filed 2-6-81 consolidating this case with 80-2614 for hearing and trial of all matters. (N) (filed in C.A. 80-2614) GREEN, JOYCE HENS, J.
Feb. 13	MOTION of Bankers Trust Company for leave to appear as Amicus Curiae and to file a memorandum of law; affidavit of John W. Barnum; Exhibit (memorandum).

Docket in Court of Appeals, Civil Action No. 80-2258

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-2258

A. G. BECKER INCORPORATED,

Petitioner,

—v.—

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM, et al.,

Respondents.

Counsel for Petitioner:

Harvey L. Pitt
Henry A. Hubschman
James H. Schropp
FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
600 New Hampshire Avenue,
N.W., #1000
Washington, D.C. 20037
342-3500

Goldman, Sachs & Co.;
amicus curiae
Leonard H. Becker
Steven A. Musher
ARNOLD & PORTER
1200 New Hampshire Ave. N.W.
Washington, D.C. 20036
872-6988

Joseph McLaughlin
GOLDMAN, SACHS & CO.
55 Broad Street
New York, NY 10004
(212) 676-8788

Counsel for Respondents:

Michael Bradfield
James V. Mattingly, Jr.
Richard M. Ashton
BD.GOV.FRS
20th & Const. Ave. N.W.
Washington, D.C. 20551
452-3430

New York Clearing House
Association; *amicus curiae*
Robert S. Rifkind
CRAVATH, SWAINE & MOORE
One Chase Manhattan Plaza
New York, NY 10005
(212) 422-3000

Bankers Trust Company;
amicus curiae
John W. Barnum
W. Michael Tupman
WHITE & CASE
1747 Penn. Ave. N.W.
Washington, D.C. 20006
872-0013

Docket Entries

DATE	*FILINGS—PROCEEDINGS*
(V)10-14-80	4–Petitioner's petition for review of an order of the Board of Governors of the Federal Reserve System (m-14)
(V)10-15-80	Certified copy of petition for review was mailed to FRS
(T)11-24-80	Certified Index to Record (n-2)
(T)12-04-80	Corrected Certified Index to Record (n-2)
(T)12-04-80	4–Petitioner's motion to use deferred appendix procedure (m-4)
(T)12-24-80	4–Petitioner's motion to extend time to file brief (m-24)
(B)12-31-80	Clerk's order that counsel for the parties are granted leave to proceed under Rule 30(c), deferred appendix
(B)12-31-80	Clerk's order that petitioner's motion to extend time is granted and the time for filing petitioner's brief is extended for a period of thirty days after disposition of the pending motion to stay proceedings, should that motion be denied
(B)08-05-81	Clerk's order that the Clerk is directed to file petitioner's motion to stay proceeding and that the time for filing petitioner's brief and appendix is extended until thirty (30) days after final decision by the United States District Court for the District of Columbia in A.G. Becker Incorporated v. Board of Governors of the Federal Reserve System, Civil Action No. 80-2614. Counsel for petitioner shall advise the Court, through its Clerk, the status of the aforesaid Civil Action within ninety (90) days from the date of this order and, if necessary, and at ninety (90) day intervals thereafter

Docket Entries

DATE	*FILINGS—PROCEEDINGS*
(B)08-05-81	4-Petitioner's motion to stay proceedings—filed per above order
(T)08-17-81	1-Letter from counsel for petitioner advising of status
(V)08-18-81	4-Petitioner's motion to extend time to file brief for a 30 day period (m-18)
(B)08-31-81	Clerk's order that the time for filing petitioner's motion to govern the future course of this proceeding is extended to either thirty (30) days after appeals are docketed in this Court from the District Court's decision in Civil Action No. 80-2614 or thirty (30) days after the time for noting such appeals expires, whichever occurs first
(V)10-26-81	4-Petitioner's motion to consolidate action Nos. 80-2258, 81-1493, 81-2070 & 81-2096 and to establish briefing schedule (m-26)
(B)11-12-81	Clerk's order that Nos. 80-2258, 81-1493 and cross-appeals 81-12070 and 81-2096 are hereby consolidated
(V)11-27-81	Respondents' motion to consolidate appeal Nos. 80-2258, 81-1493, 81-2070, 81-2096 with appeal Nos. 80-2314 and 81-2058 (m-25)
(B)12-03-81	Clerk's order that Nos. 80-2258, et al. are hereby consolidated with Nos. 80-2314 and 81-2058

Docket in Court of Appeals, Civil Action No. 80-2314

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-2314

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

Counsel for Petitioner:

John M. Liftin
James B. Weidner
Janet R. Zimmer
ROGERS & WELLS
1666 K Street, N.W.
Washington, D.C. 20006
331-7760

Goldman, Sachs & Co.;
amicus curiae:
Leonard H. Becker
Steven A. Musher
ARNOLD & PORTER
1200 New Hampshire Ave. N.W.
Washington, D.C. 20036
872-6988

Counsel for Respondents:

Richard M. Ashton
James V. Mattingly, Jr.
Board of Governors of the
Federal Reserve System
20th & Constitution Avenue, NW
Washington, D.C. 20551
452-3430

New York Clearing House
Association; *amicus curiae*:
Robert S. Rifkind
CRAVATH, SWAINE & MOORE
One Chase Manhattan Plaza
New York, NY 10005
(212) 422-3000

Joseph McLaughlin
GOLDMAN, SACHS & CO.
55 Broad Street
New York, NY 10004
(212) 676-8788

Bankers Trust Company;
amicus curiae:
John W. Barnum
W. Michael Tupman
WHITE & CASE
1747 Penn. Ave. N.W.
Washington, D.C. 20006
872-0013

DATE	*FILINGS—PROCEEDINGS*
10-24-80	4-Petitioner's petition for review of an order of the Board of Governors of the Federal Reserve System (m-24)
10-29-80	Certified copy of petition for review was mailed to BD.GOV.FRS.
12-03-80	Certified Index to Record (n-2)
12-12-80	4-Petitioner's motion to defer filing of appendix, Rule 30(c) (m-12)
12-31-80	Clerk's order that counsel for the parties are granted leave to proceed under Rule 30(c), deferred appendix
01-02-81	4-Petitioner's motion to extend time to file brief to February 11, 1981 (m-2)
01-09-81	Clerk's order granting petitioner's motion to extend time to file brief to February 11, 1981
02-02-81	4-Petitioner's motion to stay proceedings (m-2)
02-02-81	4-Petitioner's motion to extend time to file brief (m-2)
02-19-81	Clerk's order granting petitioner's motion to extend time to file brief and the time for filing petitioner's brief is extended for a period of 30 days from the date of the disposition of the pending motion to stay proceedings

Docket Entries

DATE	*FILINGS—PROCEEDINGS*
03-13-81	Per Curiam order that petitioner's motion to stay proceedings is granted pending consideration of the motion to dismiss pending in Civil Action No. 80-2370 before the US District Court for the District of Columbia, provided that either party may at any time apply to this Court for removal of this stay. Counsel are directed to promptly notify this Court of final action by the District Court; MacKinnon, Wald (who did not participate) and Mikva, CJ's
08-07-81	Letter dated 08-07-81 from counsel for petitioner advising of status
08-14-81	Letter dated 08-13-81 from Clerk to counsel for petitioner requesting an appropriate motion to govern the future course of this proceeding
08-26-81	4-Petitioner's motion to defer briefing schedule and to establish time for filing future motion (m-26)
09-02-81	Clerk's order granting petitioner's motion to defer filing schedule and to establish time for filing future motion to and including 10/9/81
10-09-81	4-Petitioner's motion to consolidate appeal Nos. 80-2314 with 81-2058 (m-9)
10-21-81	Clerk's order granting motion to consolidate actions and that the briefing schedule be established in accordance with the rules governing the schedule in No. 81-2058; consolidated with No. 81-2058

Docket in Court of Appeals, Civil Action No. 81-2058

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 81-2058

SECURITIES INDUSTRY ASSOCIATION,
Appellee,

—v.—

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM, *et al.*,
Appellants.

Counsel for Appellee:

John M. Liftin
Janet R. Zimmer
ROGERS & WELLS
1666 K Street, N.W.
Washington, D.C. 20006
331-7760

Securities and Exchange Commission; *amicus curiae:*
Paul Gonson
Russell Stevenson
SEC
500 North Capitol St., N.W.
Washington, D.C. 20549
272-2471

Counsel for Appellants:

James V. Mattingly, Jr.
Richard M. Ashton
Board of Governors of the Federal Reserve System
20th & Constitution Avenue, N.W.
Washington, D.C. 20551
452-3430

Bankers Trust Company; *amicus curiae:*
John W. Barnum
W. Michael Tupman
WHITE & CASE
1747 Penn. Ave. N.W.
Washington, D.C. 20006
872-0013

Goldman, Sachs & Co.;
amicus curiae:
Leonard H. Becker
Steven A. Musher
ARNOLD & PORTER
1200 New Hampshire Ave. N.W.
Washington, D.C. 20036
872-6988

New York Clearing House
Association; *amicus curiae*:
Robert S. Rifkind
CRAVATH, SWAINE & MOORE
One Chase Manhattan Plaza
New York, NY 10005
(212) 422-3000

Joseph McLaughlin
GOLDMAN, SACHS & CO.
55 Broad Street
New York, NY 10004
(212) 676-8788

DATE	*FILINGS—PROCEEDINGS*
09-28-81	Copy of notice of appeal and docket entries from Clerk, District Court (n-8)
10-09-81	4-Appellee's motion to consolidate appeal Nos. 81-2058 and 80-2314 (m-9)
10-21-81	Clerk's order granting motion to consolidate actions and that the briefing schedule be established in accordance with the rules governing the schedule in No. 81-2058; consolidated with No. 80-2314
11-03-81	4-Appellee's motion to establish briefing schedule (m-3)
11-12-81	Certified Original Record (2 volumes); 2 volumes of administrative record (green covers) (n-8) (this is also the record in No. 81-2071)
11-12-81	Clerk's order that the motion to establish a briefing schedule is granted and a briefing schedule is set as follows: Forty (40) days from the date the record is docketed in 81-2058—Brief of

DATE	FILINGS—PROCEEDINGS
	the Board of Governors of the Federal Reserve System, et al., to be served and filed; Forty (40) days thereafter—Brief of the Securities Industry Association to be served and filed; Thirty (30) days thereafter—Brief of the Board of Governors of the Federal Reserve System, et al., to be served and filed; Fourteen (14) days thereafter—Reply brief, if any, of the Securities Industry Association to be served and filed. Subject to further order of the Court, the Clerk is directed to calendar the above cases for argument with Nos. 80-2258, et al., on the same day and before the same panel.
11-27-81	4-Appellants' motion to consolidate appeal Nos. 80-2258, 81-1493, 81-2070, 81-2096 with appeal Nos. 80-2314 and 81-2058 (m-25)
12-03-81	Clerk's order that Nos. 80-2258, et al. are hereby consolidated with Nos. 80-2314 and 81-2058

Docket in Court of Appeals,
Civil Action No. 81-2070

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 81-2070

A. G. BECKER INCORPORATED,
a Delaware Corporation,

Appellee,

—v.—

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM, *et al.*,

Appellants.

Counsel for Appellee:

Harvey L. Pitt
Henry A. Hubschman
Andrea Newmark
FRIED, FRANK, HARRIS
SHRIVER & KAMPELMAN
600 New Hampshire Ave. N.W.
Washington, D.C. 20037
342-3500

Goldman, Sachs & Co.;
amicus curiae:
Leonard H. Becker
Steven A. Musher
ARNOLD & PORTER
1200 New Hampshire Ave. N.W.
Washington, D.C. 20036
872-6988

Counsel for Appellants:

James V. Mattingly, Jr.
Richard M. Ashton
Board of Governors of the
Federal Reserve System
20th & Constitution Avenue, N.W.
Washington, D.C. 20551
452-3430

New York Clearing House
Association; *amicus curiae*:
Robert S. Rifkind
CRAVATH, SWAINE & MOORE
One Chase Manhattan Plaza
New York, NY 10005
(212) 422-3000

Joseph McLaughlin GOLDMAN, SACHS & CO. 55 Broad Street New York, NY 10004 (212) 676-8788	Bankers Trust Company; *amicus curiae:* John W. Barnum W. Michael Tupman WHITE & CASE 1747 Penn. Ave. N.W. Washington, D.C. 20006 872-0013

DATE	*FILINGS—PROCEEDINGS*
10-01-81	Copy of notice of appeal and docket entries from Clerk, District Court (n-3)
10-26-81	4–Appellee's motion to consolidate actions Nos. 80-2258, 81-1493, 81-2070 & 81-2096 and to establish briefing schedule (m-26)
11-12-81	Clerk's order that Nos. 80-2258, 81-1493 and cross-appeals 81-2070 and 81-2096 are hereby consolidated; and that a briefing schedule is set as follows: Forty (40) days from the first filing of the records in Nos. 81-2058 or Nos. 81-2070 and 81-2096—Brief of the Board of Governors of the Federal Reserve System, et al., and any amicus curiae briefs in support of the Board to be served and filed; Forty (40) days thereafter—Brief of A.G. Becker, Inc. (not to exceed sixty (60) pages) and any amicus curiae briefs in support of Becker to be served and filed; Thirty (30) days thereafter—Brief of the Board of Governors of the Federal Reserve System, et al., to be served and filed; Fourteen (14) days thereafter—Reply brief, if any, of A.G. Becker, Inc. (not to exceed fifteen pages) to be served and filed. Subject to further order of the Court, the Clerk is directed to calendar these cases with Nos. 80-2314 and 81-2058 on the same day and before the same panel.

Docket Entries

DATE	*FILINGS—PROCEEDINGS*
11-18-81	Certified Original Record (2 volumes); 1 volume of transcript (under separate cover); and 2 volumes of administrative record (n-7) (This is also the record in 81-2069 and 81-2096)
11-27-81	4-Appellants' motion to consolidate appeal Nos. 80-2258, 81-1493, 81-2070, 81-2096 with appeal Nos. 80-2314 and 81-2058 (m-25)
12-03-81	Clerk's order that Nos. 80-2258, et al. are hereby consolidated with Nos. 80-2314 and 81-2058
12-10-81	4-Appellant's (BD.GOV.FRS.) motion to permit filing of deferred appendix (m-7)
12-11-81	4-Appellant's (BD.GOV.FRS.) motion to extend time to file brief to 01/21/82 (m-11)
12-15-81	4-Consent (styled Stipulation) of A. G. Becker, Inc. to the appearance of Bankers Trust Co. as amicus curiae (m-14)
12-16-81	Clerk's order granting parties leave to proceed under Rule 30(c), deferred appendix
01-05-82	4-Consent (Styled Stipulation) of Bd. Gov. FRS to the appearance of Bankers Trust Co. as amicus curiae (m-5)
01-21-82	1-Letter dated 12/17/81 from counsel for A.G. Becker, Inc. consenting to the filing of a brief on behalf of the New York Clearing House Assoc. as amicus curiae
01-21-82	1-Letter dated 12/18/81 from counsel for Securities Industry Assoc. consenting to a brief on behalf of the New York Clearing House Assoc. as amicus curiae

DATE	*FILINGS—PROCEEDINGS*
01-21-82	1-Letter dated 12/17/81 from counsel for BD.GOV.FRS. consenting to the filing of a brief on behalf of the New York Clearing House Assoc. as amitus curiae
01-21-82	25-Brief of the New York Clearing House Association as amicus curiae (m-21)
01-21-82	Clerk's order granting appellant's (BD. GOV. FRS) motion to extend time to file brief to 1-21-82
01-22-82	4-Motion of Bankers Trust Company as amicus curiae for leave to participate in oral argument (m-22)
01-22-82	15-Amicus Curiae (Bankers Trust Co.) brief (m-22)
01-25-82	4-Brief of Board of Governors of FRS (m-21)
02-18-82	4-Stipulation of parties consenting to leave to Goldman, Sachs & Co. to file brief as amicus curiae
03-05-82	4-Brief of Securities Industry Association (p-5)
03-05-82	15-Appellee/cross-appellant/petitioner (A.G. Becker) brief (p-5)
03-05-82	15-Amicus curiae (Goldman) brief (p-5)
03-26-82	4-Appellants' motion to extend time to file brief to 04/09/82 (m-26)
04-05-82	Clerk's order that appellants' (BD.GOV.FRS.) motion to extend time to file reply brief is granted on condition that the reply brief be hand delivered for filing in the Clerk's office by the close of business (4:00 p.m.) on 04/09/82. No further enlargement will be granted.

Docket Entries

DATE	FILINGS—PROCEEDINGS
04-05-82	15-Reply brief of Bankers Trust Co. as amicus curiae (m-5)
04-09-82	4-Reply brief of Bd. of Gov. (m-8)
04-26-82	4-Reply brief of Securities Industry Assoc. (m-23)
04-26-82	15-Reply brief of A.G. Becker, Inc. (m-26)
04-30-82	7-Joint Appendix (m-30) (Vol. I & II)
05-07-82	15-Brief of A.G. Becker as appellee/cross-appellant/petitioner (m-7)
05-07-82	15-Reply brief of A.G. Becker as appellee/cross-appellant/petitioner (m-7)
05-13-82	15-Petitioner-Plaintiff-Appellee (Securities Industry Assoc.) brief (m-12)
05-13-82	15-Petitioner-Plaintiff-Appellee (Securities Industry Assoc.) reply brief (m-12)
05-14-82	15-Brief of Bd. of Gov. as appellants (m-14)
05-14-82	15-Reply brief of Bd. of Gov. as appellants/cross-appellees/respondents (m-14)
05-26-82	Clerk's order that the motion of Bankers Trust to participate in oral argument is denied and that the following times are allotted for oral argument: Board of Governors—20 minutes on direct appeal; Securities Industry—15 minutes; A.G. Becker—15 minutes; Board of Governors reply to direct appeal issues and response to cross-appeal issues—20 minutes; A.G. Becker reply—10 minutes
06-03-82	Argued before Tamm, CJ; Robb, SCJ; and Wilkey*, CJ

DATE	*FILINGS—PROCEEDINGS*
11-02-82	Opinion for the Court filed by Circuit Judge Wilkey.
11-02-82	Dissenting opinion filed by Senior Circuit Judge Robb.
11-02-82	Judgment by this Court that the judgment of the District Court is reversed, in accordance with the opinion for the Court filed this date.
11-02-82	Mandate order.
11-02-82	Per Curiam order by the Court sua sponte that the dissenting opinion filed by Senior Circuit Judge Robb this date is hereby amended (see order for details)
11-16-82	1-Appellants' bill of costs (m-16)
12-17-82	15-Appellee/cross-appellant/petitioner (A.G. Becker) joint petition for rehearing and suggestions for rehearing en banc (m-17)
02-02-83	Per Curiam order that the joint petition for rehearing, filed 12/17/82, is denied; Tamm and Wilkey, CJs and SCJ Robb (who did not participate)
02-02-83	Per Curiam order, en banc, that the joint suggestion for rehearing en banc is denied; CJ Robinson, Wright, Tamm, MacKinnon, Wilkey, Wald, Mikva, Edwards, Ginsburg, Bork and Scalia, CJs (Circuit Judges MacKinnon and Mikva would grant the suggestion for rehearing en banc) (CJ Robinson and Circuit Judges Wald, Ginsburg and Bork did not participate in the foregoing order)

DATE	*FILINGS—PROCEEDINGS*
02-14-83	Certified copy of opinion, judgment and order of 11-2-82 and bill of costs in the amount of $697.60 issued to BGFRS and district court.
02-22-83	Receipt dated 02-22-83 from Clerk, District Court for Certified Original Record 2 vols.; 1 vol. of transcript under separate cover and 2 vols. of administrative record
05-05-83	Notice from Clerk, Supreme Court that petition for writ of certiorari was filed on 04-29-83 in SC No. 82-1766
10-06-83	Letter dated 10-05-83 from Clerk, Supreme Court asking that the record be certified and transmitted to Supreme Court
10-11-83	Letter dated 10-07-83 from Chief Deputy Clerk transmitting record to the Supreme Court
10-12-83	Clerk's order that certiorari having been granted, the Clerk of the Supreme Court has requested the transmission of the record on appeal to that Court. Accordingly the Clerk of the District Court is requested to certify and return to this Court the record on appeal previously transmitted, and since returned, in Civil Actions 80-2175, 80-2614 and 80-2730
10-13-83	Receipt dated 10-13-83 from Clerk, Supreme Court for record

Letter, dated November 19, 1971, from Robert Bloom to Richard A. Nordbye

[Letterhead of The Administrator of National Banks]

November 19, 1971

Mr. Richard A. Nordbye
Vice President & General Counsel
First National Bank of Minneapolis
Minneapolis, Minnesota 55480

Dear Mr. Nordbye:

This is in response to your letter dated November 15, 1971 concerning the possibility of the bank's acting as a dealer in commercial paper. You ask three questions concerning the application of federal banking laws and regulations to the proposed service.

First, you inquire whether dealing in commercial paper would constitute dealing in securities prohibited by the Glass-Steagall Act, 12 U.S.C. 377, 378, 78 and 24. The answer to this question depends on whether note obligations commonly known as commercial paper are considered securities for this purpose. This office has taken the position that such obligations are not "securities" for the purposes of the Glass-Steagall Act, provided such notes are exempt from registration under Section 3(a)(3) of the Securities Act of 1933, and that a national bank may deal in such exempt securities.

Secondly, you ask whether we would consider commercial paper owned by the bank as investment securities not subject to the lending limits of the bank contained in 12 U.S.C. 84. The long-standing position of the office is that commercial paper are loan assets subject to the usual rules concerning loans to single interests.

Thirdly, you ask the legal effect of the bank undertaking to repurchase commercial paper which it sells. The existence of

Letter, dated November 19, 1971

such a repurchase obligation would constitute the transaction a borrowing by the selling bank subject to its over-all debt limit pursuant to 12 U.S.C. 82. See our Interpretive Ruling 7.7519.

I trust that the above is responsive to your inquiry.

Sincerely,

/s/ ROBERT BLOOM
Robert Bloom
Chief Counsel

Letter, dated February 24, 1972, from F. H. Ellis to Robert D. Armstrong

February 24, 1972

Mr. Robert D. Armstrong
Vice President
First National Bank of Memphis
P. O. Box 84
Memphis, Tennessee 38101

Dear Mr. Armstrong:

This will acknowledge receipt of your letter of December 23, 1971, addressed to Kenneth W. Leaf, Regional Administrator of National Banks in Memphis, Tennessee, which has been forwarded to this office for reply. The bank wishes to initiate a service whereby it would act as the broker for the commercial paper issued by some of the larger local companies. This service would be handled through the bank's government bond department in a manner similar to that now in use for commercial paper and government bill transactions. Under the subject proposal, the bank would receive an order from a customer for commercial paper, which would be transmitted to the issuing company. If the paper is available, the company will deliver notes to the bank for the account of the customer.

The subject proposal raises a possible legal question concerning the Glass-Steagall Act (12 U.S.C. 378) which is generally interpreted as prohibiting commercial banks from engaging in the business of dealing in securities. The question is whether commercial paper is to be considered securities for this purpose. The Act refers to "stocks, bonds, debentures, notes, or other securities." There is no definition in the act of "other securities." The Securities Act of 1933 and the Securities Exchange Act of 1934 which were under consideration by the Congress at the same time as the Glass-Steagall Act, contain very broad definitions of securities which do include evidences of debt such as commercial paper. However, as your letter points out, there is a statutory exemption from the registration

Letter, dated February 24, 1972

requirements of the Securities Acts for the debt obligations of business corporations provided that such obligations arise out of "current transactions" and have a maturity of nine months or less. (Sec. 3(a)(3).

The intention of the Congress in providing the Section 3(a)(3) exemption from registration requirements is consistent with the general purpose of the 1933 securities legislation which was to provide disclosure and protection for the general investing public. Commercial bodies such as banks, mercantile corporations, insurance companies, etc., were considered to be sophisticated in the making of investments without need of government protection in this area.

Although no court, to our knowledge, has ruled on the question, we believe it reasonable to conclude that since commercial paper is purchased almost exclusively by financially sophisticated institutions, there was no intention in Glass-Steagall to prohibit commercial banks from engaging in the brokerage or other aspects of buying and selling such notes. Additional persuasive reasons exist for this conclusion. What is commonly known as commercial paper are after all nothing but loans to industrial corporations, a type of transaction engaged in by banks every day. Indeed, the issuance by industrial corporations of commercial paper is so closely related to ordinary bank loan activity that recently several leading New York banks have abandoned the use of an independent prime rate for commercial loans and have instead adopted a moving rate directly tied to the market rate for commercial paper.

For the reasons expressed above, it is our opinion that there is no legal bar to general dealing in commercial paper by a national bank.

Very truly yours,

F. H. Ellis
Chief National Bank Examiner

Memorandum, dated October 27, 1978, from Neal L. Petersen to Mr. Loeser.

[Letterhead of Board of Governors of the Federal Reserve System]

Date 10-21

TO: Mr. Loeser

FROM: Neal L. Petersen

Re: BTCo. Commercial Paper

Per our discussion yesterday. The attached was given to me by Jim Boechle.

[handwritten note]

Attachment to Memorandum, dated October 27, 1978 from Neal L. Petersen to Mr. Loeser.

Bankers Trust Company ("BTCo") proposes to carry on three types of activity involving commercial paper ("CP"):

(1) *Direct issue of CP*—This activity consists of acting as agent for an issuer of CP. The issuer decides how much, at what rate and for what maturity it wants to sell CP. BTCo, acting as the issuer's agent, solicits orders for such CP and sells such CP to those offerees who are interested. BTCo may also do the mechanical issuance. This activity is not forbidden for purposes of Glass-Steagall Act as a bank is permitted "[t]he business of . . . selling . . . securities . . . without recourse, solely upon the order, and for the account of customers . . .". In fact, BTCo and many other banks have been carrying on this activity for some time.

(2) *Direct Issue of CP with financial advisory services*—This activity consists of acting as agent for and financial advisor to an issuer of CP. BTCo, acting as financial advisor to the issuer, checks the market for an issuer. BTCo then advises the issuer how much, at what rate and for what maturity it should sell CP. Then BTCo, acting as the issuer's agent, solicits orders for such CP and sells such CP to those offerees who are interested. BTCo may also do the mechanical issuance. From time to time, without prior commitment, BTCo may lend short-term funds to such issuer at or near the commercial paper rate, either on open account or taking back a note. So long as there is no commitment to place the CP, or to make a loan, both the financial advisor and lender roles are outside the Glass-Steagall Act.

(3) *Buy and Sell CP in Secondary Market*—BTCo proposes to buy and sell already issued CP in the secondary market. This is the same as "discounting and negotiating" any other type of promissory note and is treated in 12 USC 24 paragraph Seventh as an activity separate from "[t]he business of dealing in securities . . .". Thus, it is an approved activity, separate

Attachment to Memorandum, dated October 27, 1978

and distinct from any activity regulated by the Glass-Steagall Act. In addition, the Glass-Steagall Act, 12 USC 24 paragraph Seventh and Part 1 of the Regulations of the Comptroller of the Currency allow a bank such as ourselves to invest in such securities within the general limits on "Type 111 securities" and we could thus buy and sell such CP as the purchase and sale of investment securities.

Although for purposes of the above discussion of these three activities, we have assumed that CP is a security within the meaning of the Glass-Steagall Act, we are not so conceding and nothing herein contained should be otherwise construed.

We wanted the Federal Reserve to be aware of these activities and our position that they are not forbidden by the Glass-Steagall Act.

Board Memorandum, dated November 14, 1978 to Files Re: Sale of Third Party Commercial Paper by a Commercial Bank.

Board of Governors of the
FEDERAL RESERVE SYSTEM

Office Correspondence Date November 14, 1978

Files

Subject: Sale of third-party commercial paper by a commercial bank.

From John Walker

On November 13, 1978, I called Mr. William Kroener (212-422-3400) of the firm of Davis Polk & Wardwell, New York, New York. Mr. Kroener had called earlier on November 13 to speak with Mr. Petersen. Mr. Kroener stated to me that his firm is advising a certain "nameless client" (most likely Morgan Guaranty) regarding commercial paper activities that would not be dissimilar from the activities presently engaged in by Bankers Trust Company ("BTCo"). Mr. Kroener quoted statements attributed to Mr. Petersen in *Corporate Financing Week* (October 30, 1978) (see attachment) and *Business International Money Report* (October 27, 1978), and he inquired as to the status of Board staff consideration of the commercial paper activities of BTCo. I stated that Board staff is considering the Glass-Steagall implications of the activity of BTCo in the sale of third-party commercial paper. Mr. Kroener inquired whether a decision would be made regarding the Glass-Steagall implications of such activity before the end of the year and I responded that I expected so. Mr. Kroener inquired whether a memorandum submitted to Board staff by his firm within two weeks would be timely and I stated that I expected so. I informed Mr. Kroener that counsel for a nonbank company might also submit a memorandum to Board staff regarding the sale of third-party commercial paper by a commercial bank.

Attachment

Excerpt from Corporate Financing Week, undated.

Corporate Financing Week

FED DECISION ON BANKERS TRUST COMMERCIAL PAPER SERVICE EXPECTED SOON. The question of whether the new service for placing a corporation's commercial paper initiated by Bankers Trust is lawful under Glass-Steagall may be answered shortly for banks regulated by the *Federal Reserve*. Fed general counsel *Neal Peterson* said he expected a decision "soon"—soon meaning in this case, he said, "closer to next week than the end of the year."

The Fed has been looking at the matter since it was learned that BT had placed $25 million of commercial paper for *American Can Co.* and about $70 million for *ITT Corp.* (CFW, 9/25, 10/2).

Peterson said one reason why the Fed now intends to act with some speed is that "we have received some [other] inquiries on this service" from banks interested in performing a parallel function. BT is a state member bank of the Reserve System, which brings it under the Reserve Board as regard the application of Glass-Steagall. At issue is whether the placement service violates Glass-Steagall's prohibition against commercial banks underwriting securities.

Board Memorandum, dated November 17, 1978, from Evelyn Hurley to Donald Kohn

Board of Governors of the
FEDERAL RESERVE SYSTEM

Office Correspondence — Date November 17, 1978

To Mr. Donald Kohn — Subject: The role of Bankers Trust in selling commercial paper

From Evelyn Hurley

In recent telephone conversations with David Skolnick, vice-president in charge of the financial advisory staff at Bankers Trust Co., we discussed the bank's role in placing commercial paper for several commercial paper issuers. Mr. Skolnick's staff is responsible for obtaining new commercial paper business as well as for selling the paper of the bank's current issuers.

Mr. Skolnick says that Bankers Trust acts as an agent/advisor to its commercial paper issuers, charging each issuer a fee for placing the paper based upon the amount of the client's paper sold by Bankers Trust during the year but not exceeding a certain stated amount. The paper is sold to the investor on a discount basis, as is customary in both the dealer and the direct commercial paper markets and the interest rate paid by the Bankers Trust issuer is determined by the rates offered in the dealer market that day for that particular quality and maturity of paper.

Contrary to reports in financial publications, Skolnick insists that Bankers Trust does not buy the paper of an issuer but merely acts as an agent to place the paper with an investor. If a portion of an issuer's paper is not sold during the trading day, Skolnick noted, Bankers Trust makes an overnight loan to the issuer using the unsold paper as collateral. The bank charges the same interest rates as the issuer would have paid if the

Board Memorandum, dated November 17, 1978

paper had been sold. Mr. Skolnick said only about two such loans had to be made and none had been made since mid-October. [MATERIAL DELETED] also continue to issue through their regular dealers, A. G. Becker and Co. and Lehman Commercial Paper Corp., respectively. Mr. Skolnick said that he ex- [MATERIAL DELETED] In addition, he is negotiating with several foreign firms that have never used the commercial paper market.

The Bankers Trust Co. representative said that he had heard that a Minneapolis bank also was placing paper for commercial paper issuers. However, he indicated that several New York banks were investigating the possibility of entering the commercial paper market as agent/advisors. He did not identify the banks.

I called Dick Gelson at the New York Federal Reserve Bank to ask if the published aggregate of total commercial paper outstanding included the outstandings of Bankers Trust. He said at present it did not. He indicated there would be a general review of all commercial paper sources next year and collection of data from Bankers Trust would be considered at that time.

Bankers Trust Company Solicitation Materials

BANKERS TRUST
RESPONDS TO YOUR
COMMERCIAL PAPER NEEDS

[Illustration]

BANKERS TRUST ADDRESSES
YOUR SHORT TERM
FINANCING NEEDS

The traditional function of wholesale banks has been to supply short-term working capital to credit-worthy companies. These banks would gather funds and relend them at a spread which would compensate them for assuming liquidity and credit risks. For some 30 years the funds took the form of demand and savings deposits. In the 1960's and especially the 1970's these funds changed in form from demand and savings deposits to mainly short term interest bearing obligations—CDs, Federal Funds, Eurodollars, commercial paper, etc. Bankers Trust, which was among the first to recognize the importance of this development, established the capability to gather funds directly from market sources at the lowest cost, while satisfying certain liquidity criteria. As the bank gained experience in obtaining funds in this fashion it became evident that increasing our liquidity through wider sales distribution of our paper also lowered our cost, and that altering maturities to offset the impact of anticipated changes in interest rates further lowered the cost.

Paralleling these changes in the banking industry, more and more corporations began to fund themselves at a lower rate through the commercial paper market. Bankers Trust believes that this development is secular and not cyclical in nature.

Consistent with our traditional role of supplying working capital to corporations, Bankers Trust has decided to offer to certain select commercial paper issuers our financial advisory expertise, which is the result of our large sales distribution and

our market-timing capability. Specifically, we propose to sell, as your agent, your commercial paper for a fee that is competitive with that of commercial paper dealers.

The Value of Expanded Commercial Paper Distribution

Our job is the same as yours—assuring a dependable supply of funds at the lowest cost. At Bankers Trust we have learned that the way to do this is to expand sales distribution. Such expansion puts you in contact with more segments of the market and enables you to stay in touch with pools of liquidity as they shift from one sector of the economy to another. Also, expanding the sales force will work to increase demand for your commercial paper. As investor coverage increases, your corporate name becomes more familiar to a broader group of potential purchasers. Thus, there are more sources to tap when an increase in funds is needed. By increasing the number of investors that buy your name, you are less dependent on the investor who demands more than the market justifies. Longer term, this results in a significant and permanent cost saving. The more investors reached, the more flexibility you have to execute funding strategies.

Why Bankers Trust Is The Best Choice To Expand Your Commercial Paper Sales Distribution

There is certainly some overlap between the investors your present dealer does business with and our own investor group. However, because of our size we talk to many investors that your dealer does not. Unlike the investment banks, whose main focus has always been on the long term markets, our sales distribution effort is aimed principally at the shorter term investor. In 1977 our dollar volume in short term market activities alone averaged $4 billion a day. This is four times the daily activity of the entire dealer commercial paper market,

and over six times the daily dollar volume of the New York Stock Exchange. Available market share data indicate that we have a major share of the government market, with over 6% of the institutional market (according to the Federal Reserve Bank, only three other Government dealers, Merrill Lynch, Salomon Brothers, and First Boston, have over 5% of this market).

We had 13% of the bankers acceptance market in 1977, a significant share among the 13 dealers. Bankers Trust has an average of $14 billion of short term purchased funds outstanding. Over time we have been able to raise funds more efficiently than our competitors and the cost of our commercial paper issuance is competitive with CIT, GMAC, and Montgomery Ward. (Exhibits attached).

The reason for our success in these areas is a unique in-house sales distribution system that has given us access to a very large, diverse group of investors. Unlike most banks, Bankers Trust reaches investors directly instead of relying upon brokers and dealers to distribute our obligations. Domestically we are in contact with over 3,000 institutional investors in a variety of economic sectors and geographic regions. We have a specialized money market sales force in New York and in an expanding regional office network (Los Angeles and Chicago at present). We have international money market sales capability in 12 locations worldwide. We are a major factor in the global dollar market. In addition to a specialized sales distribution system which rivals that of the dealers, because we are a bank we have 600 calling officers who are selling the total services of the bank every day on a global basis. We also have access to the retail investor through over 200 branch offices in New York State. Through our correspondent bank network we have extensive relationships with a large number of regional commercial banks.

Our unique sales distribution network means that as your financial advisor and agent we can expand your commercial paper sales in a way that our competitors (either bank or

dealer) cannot. Our own experience shows that this insures not only the availability of funds, but also a lower cost of funding over the longer term.

Other Benefits If Bankers Trust Sells Your Commercial Paper

Our continuous contact with the short term investor enables us to stay abreast of the latest market trends and opportunities. From time-to-time, and where appropriate, we can provide you with CP arbitrage opportunities. That is, you might use your ready access to the CP market to realize a positive return by investing in higher yielding instruments in other markets. The net effect would be to decrease your overall cost of issuance.

There are operational advantages to be gained by having Bankers Trust sell your CP. These are centralization and increased time for market access. For that CP which we sell, it would be possible to centralize all your CP operations. Not only would we sell your paper, but we could also execute note issuance, delivery and redemption. The entire process could be initiated by one phone call. Furthermore, when we sell your paper, the delivery cycle between bank and dealer is eliminated. This means we can provide you with access to the CP market over a longer period of the day than is possible with a dealer.

Finally, by having Bankers Trust sell your CP it would be possible to bring together all the components of your cash management system. At present, we can provide daily balance information and money transfer capabilities via the Cash Connector. Also, we can offer a wide product line of investment alternatives when you have excess cash. The missing link is CP. Now, by having us sell your CP, you can centralize your complete cash management operation, which will result in increased efficiency and control.

Solicitation Materials

Summary

A principal goal of the corporate financial officer is insuring the availability of funds to the corporation at the lowest possible cost. With regard to commercial paper we believe that the best way to accomplish this is to expand your sales distribution. We speak from successful experience, since we are charged with the same responsibility at Bankers Trust. Our developed sales distribution network and market expertise has accomplished these same goals for us, and we can and will put them to work for you.

MARKET SECTOR LIQUIDITY SHIFTS

Open Market Paper*

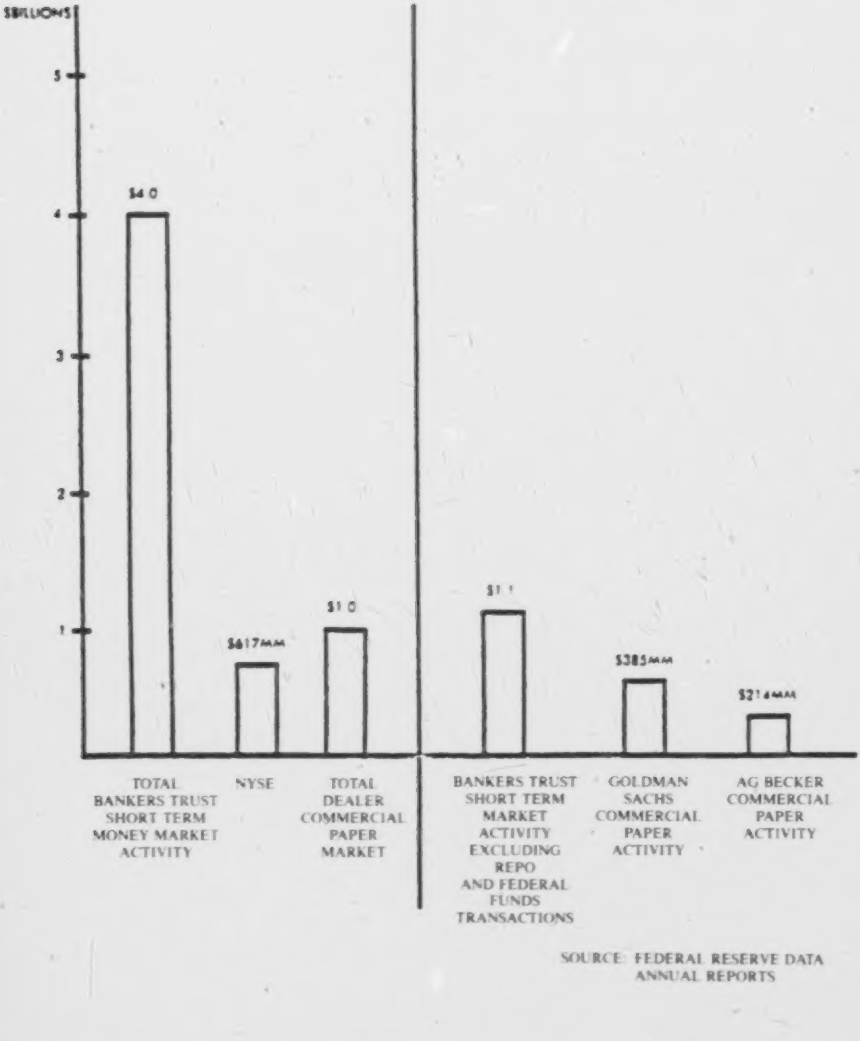
	1971	1972	1973	1974	1975	1976	1977	Projected 1978
Net Change in Open Market Paper	- .2	1.8	8.1	16.2	-1.5	8.1	14.8	12.0
Corporations	-2.3	1.4	6.5	- .6	4.3	2.2	10.3	4.0
Commercial Banks	.3	- .2	-1.3	2.2	1.1	3.7	1.8	.8
Thrifts	1.2	.4	- .6	—	.3	.9	.3	.3
Insurance Companies	.6	.3	1.6	2.8	- .9	- .7	1.2	1.0
Investment Companies	- .5	- .2	.2	.8	- .4	- .8	.4	.2
Foreign Investors	- .2	- .1	.3	6.6	-2.6	2.7	1.5	2.5
Individuals & Others	.7	.1	1.4	4.4	-3.4	.2	- .7	3.2

*Includes: Commercial Paper
Bankers Acceptances
Finance Bills

Source: Federal Reserve Bank of New York

Solicitation Materials

1977
DAILY VOLUME COMPARISONS



SOURCE: FEDERAL RESERVE DATA
ANNUAL REPORTS

SHORT TERM INSTRUMENTS IN WHICH BANKERS TRUST IS A MAJOR FACTOR

- Federal Funds-Purchased/Sold
- Repurchase Agreements
- CD's-Primary/Secondary/Foreign
- Treasury Bills and Notes
- Bankers Acceptances-Domestic/Japanese
- BTNY Commercial Paper
- Eurodollar Time Deposits
- Eurodollar CD's-Primary/Secondary
- Tax Exempt Notes
- Federal Agency Securities

SHORT TERM MARKET PRESENCE

U.S. GOVERNMENT SECURITIES

- Bankers Trust does $385 million in daily volume of Treasury bills
- This is equivalent to a 6% share of the market
- We also have 6% of the total institutional market; the only other dealers with over 5% of this market are:

  First Boston
  Merrill Lynch
  Salomon Brothers

BANKERS ACCEPTANCES

- In 1977, Bankers Trust had a 13% share of the market, or $12.5 billion annual volume
- This was achieved in competition with 13 other primary BA dealers
- We are one of only three banks recognized by the Federal Reserve as a BA dealer

Solicitation Materials

COMMERCIAL PAPER

- In 1977, total issuance of Bankers Trust amounted to $11 billion
- We accounted for 11% of the total bank holding company issuance
- In addition, we had $1 billion of issuance in the Canadian commercial paper market

FOREIGN MARKETS

- While the foreign markets are not yet a factor with regard to the domestic commercial paper market, this will change, given the evolving nature of the global dollar markets
- With $500 million daily volume in Nassau alone, Bankers Trust is already a factor in the global dollar market Bankers Trust has been a major force in the London market for 50 years

SHORT TERM MUNICIPAL NOTES

- In 1977, Bankers Trust was an underwriter of $2 billion
- This represents a 7% share of the short term municipal note market
- Bankers Trust managed 24 major, short term municipal underwritings

1977 COST OF COMMERCIAL PAPER FUNDING

	BANKERS TRUST	*GMAC*	*CIT*	*MONTGOMERY WARD*
Commercial Paper	5.50	5.58	5.96	5.48

Source: Annual Reports

Solicitation Materials

DOMESTIC SALES DISTRIBUTION

- Expanding Sales Office Network
- Specialized Money Market Sales Force in New York, Chicago, Los Angeles
- Retail Branch Network in New York State
- National Account Officer Sales Force

Solicitation Materials

SHORT-TERM DOMESTIC DOLLAR VOLUME BY INDUSTRY

Corporations	50%
Banks & Trust Departments	24%
Insurance Companies	5%
State & Local Govts.	5%
Investment Companies	3%
Other	13%

SHORT-TERM DOLLAR VOLUME BY GEOGRAPHIC REGION

Northeast	50%
Midwest	24%
Southeast	14%
Southwest	7%
Far West	5%

FOREIGN SALES DISTRIBUTION

- Specialized Money Market Sales Capability in 12 International Money Centers
- Global Contact with the Short Term Investor Through 600 Account Offices Operating in Locations in 34 Countries

FOREIGN BRANCHES

London*	Milan*	Panama City*
Nassau*	Singapore*	Bahrain*
Paris*	Tokyo*	

FOREIGN SUBSIDIARIES

Belgium	Canada*	Korea
England*	Argentina	Malaysia
Germany*	Brazil	Thailand
Italy	Australia	Nigeria
Switzerland*	Hong Kong	Tunisia

Foreign Representative Offices in 13 Other Countries

*Location Has Specialized Money Market Sales Capability

Solicitation Materials

POTENTIAL VALUE OF ARBITRAGE

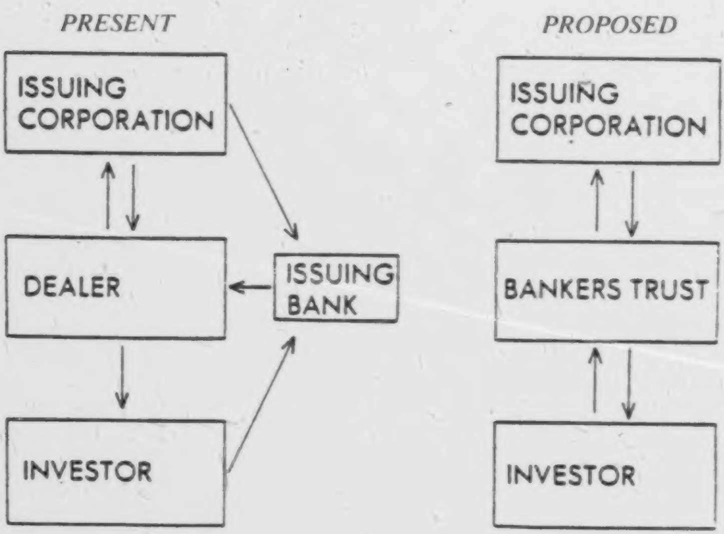
1. ASSUME
   A. Average CP outstanding $140MM
   B. Cost of issuance* ....($140M)
2. THEN
   A. Issue an additional $10MM
   in CP—invest the proceeds at a
   positive spread of 50 basis points
      a) Earnings $50M
      b) Cost of Issuance ....($10M)
3. POTENTIAL VALUE OF ARBITRAGE
   A. Total Outstanding.........................$150MM
   B. Total Cost of Issuance.....................($150M)
   C. Potential Earnings Value of Arbitrage...........$50M
   D. Net Cost of Issuance.......................($100M)
   E. Net Cost of Issuance in Basis Points ....7BP's

*Assumes financial advisory fee of 10 BP's

Solicitation Materials

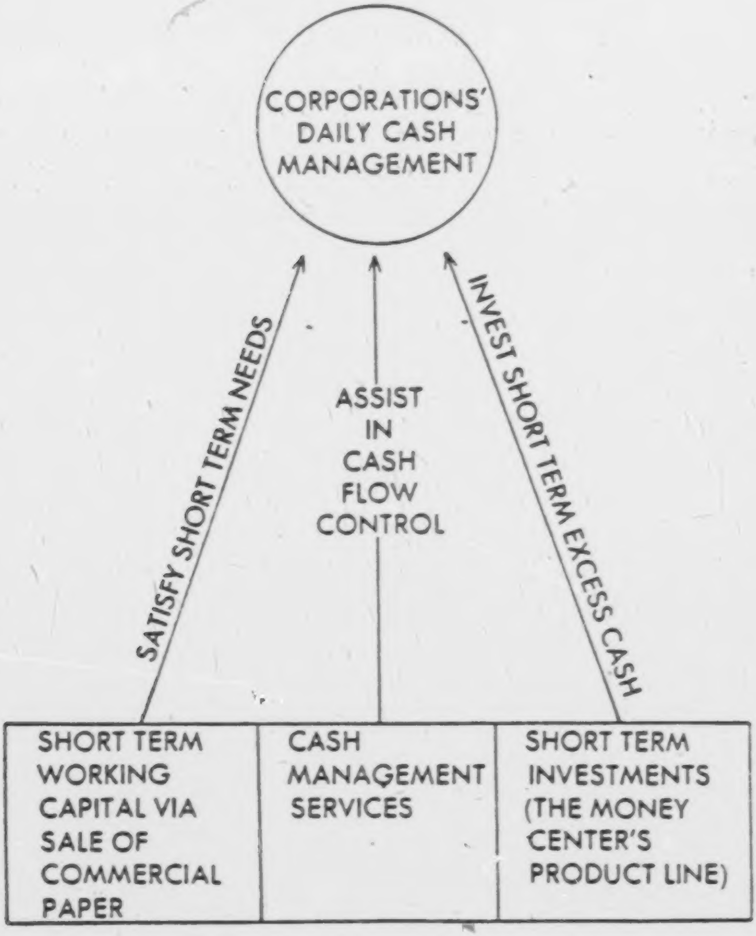
CENTRALIZED COMMERCIAL PAPER OPERATIONS

- Elimination of Delivery Time: Issuing Bank To Dealer
- Control of Sales, Issuance, Delivery, Redemption in One Location
- Flexibility to Deal with Deadlines



Solicitation Materials

COMPLETE CASH MANAGEMENT



BANKERS TRUST

MARKET SECTOR LIQUIDITY SHIFTS

Open Market Paper*

	1971	1972	1973	1974	1975	1976	1977	Projected 1978
Total Open Market Paper	- .2	1.8	8.1	16.2	-1.5	8.1	14.8	12.0
Corporations	-2.3	1.4	6.5	- .6	4.3	2.2	10.3	4.0
Banks	.3	- .2	-1.3	2.2	1.1	3.7	1.8	.8
Thrifts	1.2	.3	- .6	.2	.1	.9	.3	.3
Insurance Companies	.6	.3	1.6	2.8	- .9	- .7	1.2	1.0
Foreign Investors	- .2	- .1	.3	6.6	-2.6	2.7	1.5	2.5
Individuals & Others	.7	.1	1.4	4.4	-3.4	.2	- .7	3.2

*Includes: Commercial Paper
Bankers Acceptances
Finance Bills

Source: Federal Reserve Bank of New York

Letter, dated December 22, 1978, from James J. Baechle to Neal L. Petersen

[Letterhead of Bankers Trust Company]

December 22, 1978

Neal L. Petersen, Esq.
General Counsel
Board of Governors of the
Federal Reserve System
Constitution Avenue between
20th and 21st Streets, N.W.
Washington, D. C. 20551

Dear Mr. Petersen:

Thank you for your letter of November 22, 1978 concerning certain activities of Bankers Trust Company ("BTCo") in the sale of third party commercial paper ("CP"). In response to your questions concerning BTCo's activities, we are pleased to provide you with the following information:

(1) In acting as agent for and financial advisor to an issuer of CP, BTCo does not purchase the CP for its own account or for the account of customers (although BTCo does execute orders for customer directed investment).

(2) From time to time BTCo, without prior commitment, may lend short term funds (either its own or those of its parent holding company) at or near the commercial paper rate to those issuers for which it acts as agent and financial advisor, taking back notes, which subsequently may be sold, as evidence of indebtedness. In the case of such loans, BTCo observes established internal credit limits. These limits are consistent with the credit quality of the issuers involved, all of which are highly rated, credit worthy concerns. In any case, as a matter of policy the amount of such loans, taken together with all other loans to such issuer, may not be in excess of BTCo's legal lending limit to such issuer.

Letter, dated December 22, 1978

(3) BTCo does act as agent for its parent holding company in the solicitation of orders for and in the sale of commercial paper issued by the holding company. BTCo has engaged in such activity since the holding company began issuing commercial paper in 1969.

(4) BTCo does not place CP in accounts managed or advised by its trust department. Trust departments of banks with which BTCo maintains correspondent relationships may purchase CP from BTCo acting as agent for the issuer, just as those trust departments may purchase other high quality short-term investments from BTCo, such as Treasury bills, municipal notes, certificates of deposit and bankers acceptances. As with investment transactions with all customers, the amount of such business transacted is a function solely of BTCo's price and ability to satisfy the customer's investment requirements.

(5) BTCo, for its parent holding company, has purchased in the secondary market CP of issuers for which it acts as agent and financial advisor on four occasions. Some of the notes were sold prior to their maturity while the balance was held until maturity. In the case of such purchases, BTCo observes established internal credit limits. These limits are consistent with the credit quality of the issuer involved, all of which are highly rated, credit worthy concerns. In any case, as a matter of policy the amount of such purchases, taken together with all other loans to such issuer, may not be in excess of BTCo's legal lending limit to such issuer.

(6) BTCo sells CP to the same customers to whom it sells other short-term obligations such as Treasury bills, municipal notes, certificates of deposit and bankers acceptances. Such purchasers are located through an on-going extensive calling program on investors that have been identified as likely purchasers of short-term, high quality investments. The sources of that identification include contacts made by commercial lending officers of the bank, information gleaned from published statements of publicly held concerns, unsolicited telephone

calls by bank officers to investment officers of financial and non-financial institutions, and other conventional new business development techniques. BTCo does not maintain lists of commercial paper investors in conjunction with its role as paying agent for issuers of commercial paper. Normally, maturing commercial paper is submitted to a paying agent by an investor's clearing bank without mention of the actual investor. Although there is no numeric limit as such, BTCo does limit contacts for placement of CP to its base of institutional and other substantial purchasers of short-term investments. In the normal course of its business, BTCo does receive unsolicited calls from a small number of substantial individuals seeking short-term investment opportunities.

BTCo supplies all investors, prior to purchase, with a fact sheet on each issuer which provides general information on the issuer, including bond and commercial paper ratings and recent financial data. No representations are made to purchasers. No sale of CP by BTCo is subject to a repurchase agreement between BTCo and the purchaser.

(7) BTCo has spoken to several large credit-worthy corporations concerning the use of BTCo's CP services. The marketing effort is directed solely to highly rated issuers. Such solicitations are generally oral and in person, but a few have been written (samples enclosed). A brochure (copy enclosed) is generally left with prospective customers after each oral presentation. BTCo makes no commitments to the issuers. Prior to the inception of BTCo's CP financial advisory service, BTCo had in place advised lines of credit to most of the issuers which currently use BTCo's services. There has been no change in those lines in conjunction with those issuers using BTCo's CP services.

(8) Two directors of BTCo serve as directors of an issuer of CP for which BTCo acts as agent and financial advisor. William H. Moore is a director of both American Can Com-

pany and BTCo and William F. May is a director of both BTCo and American Can Company and is also Chairman of American Can Company. The CP business of American Can Company was solicited through financial officers. Messrs. Moore and May were not involved in the process of making the decision to use BTCo's CP services and were not even aware of the solicitation until American Can Company started to use the BTCo services.

(10) BTCo has not, at or about the time it commenced its CP services as agent and financial advisor, terminated the making of broker call loans or the extending of other types of credit to firms engaged in commercial paper sales activities. On the contrary, BTCo still extends substantial amounts of credit to firms engaged in CP sales activities.

BTCo does not have written agreements with issuers of CP for which it acts as agent and financial advisor (although it does have a written agreement if BTCo also performs the mechanical function of physically issuing CP, just as it does for issuers of CP which only use the physical issuance service and not the services of agent and financial advisor). You will find enclosed an analysis of the revenues associated with BTCo's CP services as well as a copy of the feasibility study relating to the services. As the CP services are highly integrated with other activities of BTCo's Money Market Center, it is not feasible to accurately determine the expenses that might be allocated to CP services as a "stand-alone" activity.

Due to the pressure of another matter, it has been impossible for us to complete a separate legal analysis within the time you desired a reply. In any case, we feel that our response makes clear that our activities are permissible. However, if after reading our response you have any further questions, either factual or legal, we would be most happy to respond to such questions.

Letter, dated December 22, 1978

We regard your inquiry as part of the examination process and therefore your letter and this reply are confidential communications between us, and we hereby request that all such communications be kept confidential.

Sincerely yours,

(Signature illegible)

JJB/hb

Bankers Trust Company Solicitation Materials

July 6, 1978

Dear

Let me again thank you for spending your time and sharing your thoughts with us at our recent meeting. As you will remember, our discussion centered around the value of expanding the distribution of your commercial paper by having Bankers Trust act as a seller. Your suggestion was that, as a test of our ability, we receive an allocation of your paper to sell and then be measured on performance over a period of time, perhaps a year or so.

We would welcome this opportunity. In our opinion, an allocation of \$10-\$25 million would be suitable for this purpose, however there are a number of reasons why a larger (i.e. \$25-\$50 million) allocation is preferable:

1. Our performance in placing your paper is more fairly measured when larger amounts are sold. It may not be as relevant to compare our sales capability when smaller amounts (i.e. less than \$10 million) are placed.

2. We are confident that our developed sales distribution system and the attention we will give you will generate savings for you over time. The larger the amount we sell the more meaningful and measurable the savings will be in absolute terms.

3. Most importantly, with a larger amount to sell, more of our customers will become acquainted with your name which, in essence, is our primary and mutual objective.

We are sincerely interested in serving by selling its commercial paper. If you have any questions, please let me know. In the meanwhile, I have asked to follow up with

Kindest regards.

Sincerely,

Executive Vice President

cc: Messrs.

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Solicitation Materials

[Letterhead of Bankers Trust Company]

July 25, 1978

Dear

Many thanks to you and for taking the time from your busy schedules to have lunch with us on Monday. We were pleased with your agreement concerning the advantages to be derived from expanded distribution and increased competition through the use of more than one commercial paper dealer.

Attached is our proposal to act as your agent to sell your commercial paper. Given that should continue to experience an increasing need for commerical paper, it makes sense to expand the distribution of your commercial paper with the addition of another selling agent. For those reasons outlined in the attached proposal, Bankers Trust is ideally and uniquely suited to provide that expanded distribution.

Very truly yours,

Senior Vice President

Enclosure

Solicitation Materials

COMMERCIAL PAPER PROPOSAL

BANKERS TRUST ADDRESSES
YOUR SHORT TERM
FINANCING NEEDS

The traditional function of wholesale banks has been to supply short-term working capital to credit-worthy companies. These banks would gather funds and relend them at a spread which would compensate them for assuming liquidity and credit risks. For some 30 years the funds took the form of demand and savings deposits. In the 1960's and especially the 1970's these funds changed in form from demand and savings deposits to mainly short term interest bearing obligations—CD's, Federal Funds, Eurodollars, commercial paper, etc. Bankers Trust, which was among the first to recognize the importance of this development, established the capability to gather funds directly from market sources at the lowest cost, while satisfying certain liquidity criteria. As the bank gained experience in obtaining funds in this fashion it became evident that increasing our liquidity through wider sales distribution of our paper also lowered our cost, and that altering maturities to offset the impact of anticipated changes in interest rates further lowered the cost.

Paralleling these changes in the banking industry, more and more corporations began to fund themselves at a lower rate through the commercial paper market. Bankers Trust believes that this development is secular and not cyclical in nature.

Consistent with our traditional role of supplying working capital to corporations, Bankers Trust has decided to offer to certain select commercial paper issuers our financial advisory expertise, which is the result of our large sales distribution and our market-timing capability. Specifically, we propose to act as your agent, (along with A G Becker and Merrill Lynch) to sell your commercial paper for a fee that is competitive with that of the other dealers.

Solicitation Materials

THE VALUE OF EXPANDED COMMERCIAL PAPER DISTRIBUTION

Our job is the same as yours—assuring a dependable supply of funds at the lowest cost. At Bankers Trust we have learned that the way to do this is to expand sales distribution. Such expansion puts you in contact with more segments of the market and enables you to stay in touch with pools of liquidity as they shift from one sector of the economy to another. Also, expanding the sales force through the addition of another selling agent will work to increase demand for your commercial paper. As investor coverage increases, you are able to access a broader group of potential purchasers. Thus, there are more sources to tap when an increase in funds is needed. By increasing the number of investors that buy your name, you are less dependent on the investor who demands more than the market justifies. Longer term, this results in a significant and permanent cost saving. The more investors reached, the more flexibility you have to execute funding strategies.

WHY BANKERS TRUST IS THE BEST CHOICE TO EXPAND YOUR COMMERCIAL PAPER SALES DISTRIBUTION

There is certainly some overlap between the investors you present dealers do business with and our own investor group. However, because of our size we talk to many investors that your dealers do not. Unlike the investment banks, whose main focus has always been on the long term markets, our sales distribution effort is aimed principally at the shorter term investor. In 1977 our dollar volume in short term market activities alone averaged $4 billion a day. This is four times the daily activity of the entire dealer commercial paper market, and over six times the daily dollar volume of the New York Stock Exchange. Available market share data indicate that we have a major share of the government market, with over 6% of the institutional market (according to the Federal Reserve

Bank, only three other Government dealers, Merrill Lynch, Salomon Brothers, and First Boston, have over 5% of this market).

We had 13% of the bankers acceptance market in 1977, a significant share among the 13 dealers. Bankers Trust has an average of $14 billion of short term purchased funds outstanding. Over time we have been able to raise funds more efficiently than our competitors and the cost of our commercial paper issuance is competitive with CIT, GMAC, and Montgomery Ward.

The reason for our success in these areas is a unique inhouse sales distribution system that has given us access to a very large, diverse group of investors. Unlike most banks, Bankers Trust reaches investors directly instead of relying upon brokers and dealers to distribute our obligations. Domestically we are in contact with over 3,000 institutional investors in a variety of economic sectors and geographic regions. We have a specialized money market sales force in New York and in an expanding regional office network (Los Angeles and Chicago at present). We have international money market sales capability in 12 locations worldwide. We are a major factor in the global dollar market. In addition to a specialized sales distribution system which rivals that of the dealers, because we are a bank we have 600 calling officers who are selling the total services of the bank every day on a global basis. We also have access to the retail investor through over 200 branch offices in New York State. Through our correspondent bank network we have extensive relationships with a large number of regional commercial banks.

Our unique sales distribution network means that as your financial advisor and agent we can expand your commercial paper sales in a way that our competitors (either bank or dealer) cannot. Our own experience shows that this insures not only the availability of funds, but also a lower cost of funding over the longer term.

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Solicitation Materials

SUMMARY

A principal goal of the corporate financial officer is insuring the availability of funds to the corporation at the lowest possible cost. With regard to commercial paper we believe that the best way to accomplish this is to continue to expand your sales distribution as your needs for commercial paper continue to increase. We speak from successful experience, since we are charged with the same responsibility at Bankers Trust. Our developed sales distribution network and market expertise has accomplished these same goals for us, and we can and will put them to work for you.

Solicitation Materials

[Letterhead of Bankers Trust Company]

November 3, 1978

Dear Mr.

and I recently spoke about your meeting with . As the topic of commercial paper was discussed, has asked me to send you a letter outlining the operational procedures and our fee structures.

We would be prepared to act as one of your agents and financial advisors in the distribution of commercial paper. With our ability to distribute short-term money market securities, Bankers Trust is readily suited to help meet its short-term working capital requirements through the placement of commercial paper with investors, However, in those rare occasions in which we would be unable to satisfy all of requirements through the placement of paper with investors, we may, from time-to-time and without prior commitment, lend money at the commercial paper rate and take back a commercial paper note. We feel that this policy permits Bankers Trust to be completely competitive in providing with the short-term working capital it needs at the best possible price.

Our fee structure is also designed to keep Bankers Trust competitive. Our aim is not to attract business by cutting price but rather to offer a quality service at a fair price. Therefore, we would propose a rate schedule based on daily average outstandings as follows: .10% per annum on the first 100 million, .075% per annum on the next $100 million and .05% per annum above $200 million. The financial advisory fee would be calculated on a 360-day year, rather than a 365-day year.

The financial advisory fee is certainly an element in the total cost of placing commercial paper. However, in analyzing all the components of the cost of commercial paper, an issuer should bear in mind that the breakdown is roughly as follows: 9.25%

to the investor, plus .93% to pay for the back-up lines (assumes 10% compensating balances), plus .10% financial advisory fee.

Clearly, the largest component is that rate paid to the investor. By having two selling groups placing   commercial paper, there will be an increase in the total market awareness of   paper. This will lead to an increase in demand for the paper, and over time, will result in a lower average rate paid to the investor.

With regard to the mechanical aspects of note issuance, delivery and redemption, Bankers Trust offers a quality service at very competitive terms. We charge $6 per note issued and 65¢ per note for redemption.

As we discussed during our meeting in September, there is value in having Bankers Trust both place your notes with investors and provide the issuance of those notes. The value is derived from the fact that it streamlines your operations (the delivery cycle between the dealer and bank is eliminated) and allows us to be in the market one and one-half hours longer on your behalf. Nevertheless, while there is value in having Bankers Trust both issue commercial paper as well as place your paper with investors, it should be made clear that we are certainly capable of placing the commercial paper without providing the issuance service. In other words, if   does decide to employ Bankers Trust on a trial basis in order to ascertain the benefits of broader distribution and competition, it would be possible to do so without having us also provide the note issuance.

I would like to reiterate Bankers Trust's interest in participating in   commercial paper activity. We have the demonstrated expertise in the short-term markets. Because we are a bank, we are the short-term money market experts. All we would ask for is the opportunity to demonstrate our capabilities. One suggestion in which this could be done would be to give us $25-50 million of   commercial paper to place on

a trial basis (6 mos. to one year for example). During this period, we would hold the financial advisory fee in escrow. If at the end of that trial period the cost of the commercial paper we raised was greater than that of the competition, (assuming comparable maturities), we would refund the difference out of the financial advisory fees held in escrow. What would be receiving, at no risk, would be the chance to learn first hand about the value of competition and increased distribution.

We at Bankers Trust would look forward to discussing this subject with you at greater length and in more detail. If you have any plans to be in New York we would ask that you include us in your schedule. In the meantime, we would hope to see you again in . If there are any questions, please do not hesitate to give me a call at (212) 775 or send me a telex at 426955.

Sincerely,

Vice President

/dl

November 21, 1978

Dear

It was good talking to you again last week. I am happy to see that continues to be so successsful, due, I'm sure, in no small part to the efforts you have contributed. I was also pleased to hear that the possibility exists, after years of being a lender of funds, that might be a borrower of funds via commercial paper. Toward that end, I have enclosed some information you may find interesting on commercial paper. I have included some general historical articles about the commercial paper market, an article complementary to our efforts, as well as some check-lists of the information required by the rating agencies.

As we discussed, probably the most important consideration in entering the commercial paper market is having the top ratings. As a strong "AA" credit with a well known name, and a large market share this should not be a difficult step. We have contacts in the commercial paper rating areas of each of the three rating agencies and would be most happy to either provide the introductions or do whatever else you may deem appropriate if you should desire to initiate the rating process.

Besides having the top rating, a successful commercial paper funding operation is best achieved through having the broadest possible distribution. This is accomplished by using more than one selling agent. As you are aware, while there is a great deal of overlap, no one agent can possibly do business with all short-term money market investors. By using more than one selling agent, the money market access for paper is broadened. This should lead to an increase in demand for paper and, over time, this will result in a reduced cost of funding.

The other benefit to be derived from using more than one selling agent is competition. With competition, it is possible to have an objective standard of comparison against which to

measure performances over time. There is no other area of your business which is not characterized by some degree of competition. There is no reason why a commercial paper funding operation should be any different.

As you are aware, Bankers Trust Company has recently become an agent and financial advisor in the distribution of commercial paper. Thus far we are acting on behalf of . Because we are a large bank as well as a significant factor in the short-term money markets, we feel we can make a contribution to this business. Unlike the investment bankers, whose concentration has always been on the long-term markets, Bankers Trust, with over $14 billion in short-term liabilities is necessarily a short-term money market expert. Unlike other money center banks who are more apt to rely on others (ie dealers) to fund their short-term needs, Bankers Trust has a highly specialized short-term money market sales force which concentrates on reaching the end investors. Since we can do the issuance, delivery and redemption of commercial paper, these are operational advantages to be gained by using us to place commercial paper.

I could probably wax enthusiastically for two more pages about the advantages of Bankers Trust versus other money center banks and other dealers. Very simply, however, the argument is that, if should decide to enter the commercial paper market, there are some strong reasons why it would pay to have more than one selling agent. Further, there are strong reasons why one of those selling agents should be Bankers Trust. To that end I would look forward to seeing you at any time in or in New York to discuss this topic in more depth and in more detail.

Sincerely,

Vice President

/dl
enc.

Excerpt from memorandum, dated January 31, 1979, from the Securities Industry Association to the Board

Potential Hazards of Banks Distributing Commercial Paper

The SIA believes Bankers Trust's activities constitute such a clear violation of sections 16 and 21 of the Glass-Steagall Act that no analysis of the public policy objectives of the Act is necessary or even useful as a guide to its construction. Nevertheless, it can readily be demonstrated that many of the potential hazards cited by the Supreme Court in *Investment Company Institute* v. *Camp** are present in the distribution by a bank of commercial paper. The most obvious of these potential abuses relevant to commercial paper sales are:

(1) The investment by a bank of its own assets in frozen or otherwise imprudent securities investments.

Whenever Bankers Trust is unable to place an issue of paper successfully it, in effect, buys the remainder for its own account. This could mean a significant allocation of its assets to the credit of issuers whose paper is the most difficult to place, *i.e.*, those whose credit is least acceptable to buyers of commercial paper. Thus, the liquidity and prudence of such paper as an investment may be questionable.

(2) The exposure of a bank to promotional and other pressures, such as to make its credit facilities more fully available to those companies whose securities the bank has distributed.

Where a commercial paper issuer finds itself in unexpected financial difficulty, the bank which placed its paper may feel obligated to extend a loan that might not otherwise conform to its normal credit standards to avoid possible embarrassment and damage to its reputation among the investors who had purchased the paper. In other instances, a bank may decide, in the face of threat-

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* 401 U.S. 617 (1971).

Excerpt from memorandum, dated January 31, 1979

ened litigation by the investor under the securities laws, that it is in the bank's best interest to provide a loan to help the issuer over its financial problems. Although a bank undoubtedly would not lower its lending standards merely to earn commercial paper fees, it might feel that, after the fact, either damage to its standing in the financial community or potential legal liability could justify a shading of its normal requirements.

(3) The incurring by bank depositors of losses on investments they have purchased in reliance upon the bank's reputation.

Although Bankers Trust describes its prospective market for commercial paper as consisting largely of institutions and "substantial" individuals, it was noted above that in the promotional material made available Bankers Trust touted its "access to the retail investor through over 200 branch offices in New York State." Clearly, this suggests depositors are not considered off limits as prospective purchasers of commercial paper; thus, depositors will be exposed to the risk of loss on their investments purchased through Bankers Trust.

(4) The use by banks of their reputations for prudence and restraint in selling securities.

Bankers Trust states in its December 22 letter that it sells commercial paper to the same investors to whom it sells other short-term obligations, such as Treasury bills, municipal notes, certificates of deposit and bankers acceptances. Surely there is a distinction in credit between the issuers of instruments such as these (the Federal government, municipal governments and banks) and the issuers of commercial paper. Yet by lending its name to the paper it sells, Bankers Trust may be implying that it regards the risks as comparable in its banking judgment.

Excerpt from memorandum, dated January 31, 1979

(5) The danger that banks might make loans to investors to facilitate the purchase of securities being distributed by the bank.

The information made available to us indicates no reason why Bankers Trust could not make loans to finance purchases of commercial paper.

(6) The obvious conflict between the promotional interests of the investment banker and the obligation of the commercial banker to render disinterested investment advice.

This conflict can take the banker out of his accustomed role and give him a pecuniary interest in recommending particular investments to persons who regard his advice as independent and objective. The conflict of course would be exacerbated in a situation where a bank were distributing commercial paper on behalf of an issuer which planned to use the proceeds of the sale to retire or pay down its indebtedness to the bank.

Many of these hazards may seem remote so long as Bankers Trust is distributing commercial paper of solvent, blue chip issuers. The Board undoubtedly recalls, though, that in recent history the commercial paper and other debt obligations of what were thought to be some of the nation's best-established credits have been demonstrated to be much riskier than imagined and, in some cases, virtually worthless.*

* * *

While the policies underlying the Glass-Steagall Act compel the conclusion that Bankers Trust's commercial paper activities constitute a violation of that Act, we believe it is unnecessary for the Board to engage in a "hazards" analysis of the present facts. The Board's job is not to decide whether bank under-

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* See *e.g.*, "The Financial Collapse of the Penn Central Company", *Staff Report of the Securities and Exchange Commission* (August, 1972); "Transactions in Securities of the City of New York", *Securities and Exchange Commission Staff Report* (August, 1977).

Excerpt from memorandum, dated January 31, 1979

writing of securities still presents risks to the economy and the banking system; that task was performed in 1933 by Congress. Until Congress acts to amend the judgment it then made, the Board's role is simply to apply that judgment to the present facts.

As demonstrated by the foregoing discussion of the legal issues, that task in this case is straightforward. Commercial paper clearly is a security for purposes of both sections 16 and 21. Section 16 prohibits

Excerpts from letter, dated February 2, 1979, from James J. Baechle to Neal L. Petersen

[Letterhead of Bankers Trust Company]

February 2, 1979

Neal L. Petersen, Esq.
General Counsel
Board of Governors of the
Federal Reserve System
Constitution Avenue between
20th and 21st Streets, N.W.
Washington, D.C. 20551

Dear Mr. Petersen:

Further to my letter of December 22, 1978 concerning certain activities of Bankers Trust Company ("BTCo") in the sale of third party commercial paper, and as requested in your letter of November 22, 1978, I am submitting an analysis of factual and legal considerations leading to the conclusion that BTCo's commercial paper activity is part of its traditional banking function of assisting corporations in financing their short term needs and not a violation of the Glass-Steagall Act.[1]

1. *Background*

Commercial paper is a well accepted means for corporations to raise funds for current business transactions through the issuance of short term promissory notes.[2] Because commercial paper notes are unsecured and bear only the obligation of the borrower, the market has been generally dominated by large corporations with impeccable credit ratings.[3] Historically banks were the largest purchasers of commercial paper[4] but in recent times they have been joined by other substantial investors, mostly institutional investors and other corporations.

In addition to their commercial paper purchases, commercial banks have traditionally advised and assisted corporate customers (including issuers of commercial paper) in obtaining

Excerpts from letter, dated February 2, 1979

[Material omitted in printing.]

In fact, a piece of commercial paper (which by law must be short term) is indistinguishable in substance from a note taken by a commercial bank to evidence a traditional short-term loan. Thus, there are no unknowns in the commercial paper markets.

BTCo's commercial paper activity, as outlined below, is nothing more than a continuation of the traditional activities of commercial banks, as outlined above.

II. *BTCo's Commercial Paper Activity*

The activity consists of acting as financial adivsor to and agent for an issuer of commercial paper. BTCo, acting as financial advisor to the issuer, checks the market for the issuer. BTCo then advises the issuer how much, at what rate and for what maturity it should sell commercial paper. Then BTCo, acting as the issuer's agent, sells such commercial paper to those who are interested. BTCo also may do the mechanical issuance.

BTCo makes no commitments to the issuers to place any amount of commercial paper. From time to time BTCo, without prior commitment, may lend short term funds at or near the commercial paper rate to those issuers for which it acts as agent and financial advisor, taking back notes, which subsequently may be sold, as evidence of indebtedness. In the case of such loans, BTCo observes established internal credit limits. These limits are consistent with the credit quality of the issuers involved, all of which are highly rated, credit worthy concerns. In any case, as a matter of policy the amount of such loans, taken together with all other loans to such issuer, may not be in excess of BTCo's legal lending limit to such issuer.

On occasion BTCo may purchase in the secondary market commercial paper of issuers for which it acts as agent and financial advisor. Some of the notes may be sold prior to their maturity while others may be held until maturity. In the case of

Excerpts from letter, dated February 2, 1979

such purchases, BTCo observes established internal credit limits. These limits are consistent with the credit quality of the issuer involved, all of which are highly rated, credit worthy concerns. In any case, as a matter of policy the amount of such purchases, taken together with all loans to such issuer, may not be in excess of BTCo's legal lending limit to such issuer.

BTCo supplies all investors, prior to purchase, with a fact sheet on each issuer which provides general information on the issuer, including bond and commercial paper ratings and recent published financial data. No representations are made to purchasers. No sale of commercial paper by BTCo is subject to a repurchase agreement between BTCo and the purchaser.

Please refer to my letter of December 22, 1978 for information on our marketing efforts or other details of our program.

III. *Commercial Paper and the Glass-Steagall Act*

The Comptroller of the Currency has long permitted national banks to act as dealers in commercial paper on the grounds that note obligations commonly known as commercial paper are not considered securities for the purposes of the Glass-Steagall Act. Thus, on November 19, 1971, the then Chief Counsel of the Comptroller of the Currency wrote to an inquiring national bank:

> ". . .you inquire whether dealing in commercial paper would constitute dealing in securities prohibited by the Glass-Steagall Act, 12 U.S.C. 377, 378, 78 and 24. The answer to this question depends on whether note obligations commonly known as commercial paper are considered securities for this purpose. This office has taken the position that such obligations are not 'securities' for the purposes of the Glass-Steagall Act, provided such notes are exempt from registration under Section 3(a)(3) of the Securities Act of 1933, and that a national bank may deal in such exempt securities.". . .and. . ."The long-stand-

> ing position of the office is that commercial paper are loan assets. . ."[9]

We understand from the national bank recipient of that letter that the activity permitted has been carried on successfully and without incident, notice or ill-effect for approximately seven years.

As set forth in the preceding sections, we too find commercial paper indistinguishable from an ordinary short term commercial bank loan evidenced by a note and therefore we

[Material deleted.]

Letter, dated April 20, 1979, from Ralph C. Ferrara to Neal Petersen

[Letterhead of SECURITIES AND EXCHANGE COMMISSION]

April 20, 1979

Neal L. Petersen, Esq.
General Counsel
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Neal:

This responds to your letter of April 12, 1979, and the two enclosures (a draft letter to Bankers Trust Company, and a draft position paper of the Board's Legal Division entitled "Bank Commercial Paper Activities: An Interpretation of the Glass-Steagall Act") regarding the offer and sale by Bankers Trust Company of commercial paper issued by certain corporations. We appreciate very much the opportunity to share our thoughts with you before your position is announced formally. As we discussed on the phone, given your strict time schedule, it was not possible to evaluate comprehensively your draft letter and position paper. For the same reason, our comments have not been formally reviewed by the Commission. However, if your proposed letter and position paper come before the Board of Governors, we would appreciate an opportunity to present a more comprehensive analysis after Commission review.

As you know, the Commission has a continuing interest in the securities-related activities of commercial banks. In its 1977 Bank Study, for example, the Commission compared the regulation of broker-dealers with the regulation of similar securities activities of banks.[1] And, the Commission has a special interest

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1 Securities and Exchange Commission, *Reports on Banks Securities Activities, Pursuant to Section 11A(e) of the Securities Exchange Act*

Letter, dated April 20, 1979

in the sale of commercial paper because of the recent problems surrounding the sale of commercial paper by Penn Central Company.[2] The Commission's report on the financial collapse of Penn Central described the adverse impact on investors when Penn Central went into bankruptcy with $40 billion of its "prime" commercial paper outstanding.

At the outset, however, we wish to emphasize that our interest is not in the traditional lending activities of banks whereby a commercial bank takes a note from an issuer as documentation of a lending agreement. Where a commercial bank lends money in exchange for the issuer's note, the type of Glass-Steagall questions with which your paper deals do not arise, even if these notes are popularly called commercial paper. By contrast, as we understand Bankers Trust Company's commercial paper activities, it offers and sells paper issued by major corporations to purchasers throughout the country. In the Bankers Trust Company situation, the ultimate lender is not the commercial bank; rather, the commercial bank's role is that of underwriter, distributor and/or dealer in commercial paper to a third party.

With respect to Banker Trust's activities, we have three main points. First, we question whether the word "security" in the Glass-Steagall Act should be limited, contrary to the plain words of the statute, to "investment security" or "speculative security." Second, we suggest that a more appropriate approach would be to apply the definition of "security" in the Securities Act to the Glass-Steagall Act, since the Acts were

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of 1934, Senate Comm. on Banking, Housing and Urban Affairs, 95th Cong., 1st Sess. (Comm. Print 1977).

2 *Staff Report of the Securities and Exchange Commission to the Special Subcomm. on Investigation of the Home Comm. on Interstate and Foreign Commerce, The Financial Collapse of the Penn Central Company* (Subcomm. Print 1972) [hereinafter cited as "*Penn Central Report*"].

passed within three weeks of each other. Third, we believe that the application of the definition of "security" from the Securities Act to Bankers Trust's activities would comport with the objectives of Congress in passing the Glass-Steagall Act.

To begin with, the staff's position paper asserts that the term "security" as used in Sections 16 and 21 of the Glass-Steagall Act (12 U.S.C. 24 ¶ 7 and 378) means an obligation "of the kind that is commonly known as an investment security," or is otherwise "predominantly speculative in nature." But this assertion appears to be contrary to both the language and the legislative history of the Glass-Steagall Act. With respect to the distinction between investment and non-investment securities, Section 16 of the Act broadly prohibits banks from dealing in or underwriting "securities and stock." By contrast, Congress chose the narrower term "investment securities" to describe what types of securities banks could purchase for their own account. Although Section 16 as passed in 1933 used the term "investment securities" in defining the scope of the prohibition against bank dealing or underwriting, the 1935 amendments broadened the language to its current extent, thus establishing that Congress specifically did *not* intend to limit the prohibition against bank dealing or underwriting to "investment" securities.[3]

Moreover, the staff's position paper does not set forth persuasive support for its conclusion that the determination as to whether obligations are "securities" should hinge on whether they are more or less speculative. While it is clear that the Glass-Steagall Act was in part a response to concern about speculation in securities, the position paper does not demonstrate that Congress intended that the prohibition against dealing or underwriting would apply only with respect to

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3 The 1935 amendment to Section 16 made it consistent with Section 21, which, as originally passed in 1933, prohibited a dealer or underwriter in "stocks, bonds, debentures, notes, or other securities" from also engaging in the business of commercial banking.

highly speculative securities. The legislative history of the Glass-Steagall Act which is cited consists of general statements which are inadequate authority in the absence of direct commentary on Sections 16 and 21.

The staff position paper places reliance on three items from the legislative history of the Act as passed in 1933 in support of its position that an obligation must be speculative to be a "security"—a passage in Senate Resolution 71 concerning the scope of the hearings ordered by Congress with respect to the nation's banking system, the preamble to the Act, and a Senate Report on the Act. The passage in Senate Resolution 71 concerning the scope of the hearings on the national banking system does not provide evidence that only highly speculative bank securities activities were considered within the scope of the hearings. Nor do the statements in the preamble to the Act and in the Senate Report suggest that Congress intended to make a distinction between more and less extreme cases of bank abuses, or to elevate the degree of speculativeness to a test for the applicability of Sections 16 and 21. In addition, the staff interpretation relies on the Board's 1933 letters to Congress concerning legislation which eventually became the Securities Act of 1933 for the proposition that commercial paper is not a "security" for purposes of the Glass-Steagall Act. The Board's position with respect to the treatment of commercial paper for purposes of securities regulation seems irrelevant, however, since, as discussed below, the Securities Act as subsequently passed treats such paper as securities.

Instead of focusing on "investment security" or "speculative security" through a selective reading of the legislative history of the Glass-Steagall Act, we believe that the proper inquiry is whether the commercial paper distributed by Bankers Trust is a "security" as that term was understood by Congress in 1933. Although Congress did not define "security" in the Glass-Steagall Act, it did define this term in the Securities Act,[4]

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4 Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1).

which was enacted only a few weeks earlier. The Senate Committee on Banking and Currency had responsibility for, and conducted extensive hearings concerning, both pieces of legislation. Because of Congress' concurrent consideration of these bills, the Securities Act definition of "security" should be used in defining "security" under the Glass-Steagall Act. Indeed, the staff of the Federal Reserve Board has recently concluded that where securities-related terms were defined in the Securities Act, and not defined in the Glass-Steagall Act, Congress intended the Securities Act definition to apply to the Glass-Steagall Act.[5]

Section 2(1) of the Securities Act defines a "security" to include any "note" or "evidence of indebtedness." Since the commercial paper distributed by Bankers Trust is clearly a "note" and an "evidence of indebtedness", it is a "security", and therefore subject to the antifraud provisions of the Securities Act.[6] While the definition of a "security" in Section 2(1) is prefaced by the phrase "unless the context otherwise requires", this phrase has been interpreted to exclude only commercial paper used in mercantile transactions and not for investment purposes.[7] And, a party asserting that any note is not a

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5 *See* Federal Reserve Board Staff, *Commercial Bank Private Placement Activities* (1977). In discussing the meaning of the word "issue" for purposes of the Glass-Steagall Act, the staff stated: "It is unlikely that Congress intended to give a content to the term as used in Glass-Steagall different from that given to the term in the Securities Act of 1933, which was enacted less than three weeks earlier." *Id.* at 87 n.6. The staff further stated that although the Securities Act definition of "underwriter" is not binding for Glass-Steagall purposes, "in view of the fact that Glass-Steagall was enacted only a few weeks after the Securities Act, Congress' use of the same terms in the two measures suggests that the Securities Act is a compelling analogy." *Id.* at 89.

6 Securities Act of 1933, Section 12(2), 15 U.S.C. 77*l*(2); Sections 17(a), (c), 15 U.S.C. 78q(a), (c).

7 *See, e.g., C.N.S. Enterprises, Inc.* v. *G & G Enterprises, Inc.*, 508 F.2d 1354 (7th Cir.), *cert. denied,* 423 U.S. 825 (1975); *McClure* v. *First*

"security" under the Securities Act has the burden of establishing that "the context otherwise requires."[8] As Bankers Trust's promotional literature illustrates, it is selling commercial paper of corporations to investors seeking to maximize short-term profits. Bankers Trust has not met the burden of showing that it is selling these notes in the type of purely commercial transactions that would justify removing the notes from the protection of the Securities Act.

Our view is reinforced by the legislative history of Section 3(a)(3) of the Securities Act,[9] which exempts from the registration requirements of that Act[10]—but not from its antifraud provisions—"any note *** which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months ***." The original draft of the bill that became the Securities Act of 1933 provided no exemption from registration for short-term commercial paper.[11] The Section 3(a)(3) exemption evolved as a result of the comments and testimony of several parties, including the Federal Reserve Board, during the committee hearings on this draft. These parties argued that an exemption from the registration requirements was warranted because many businesses

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Nat'l Bank, 497 F.2d 490 (5th Cir. 1974); *Lino* v. *City Investing Co.*, 487 F.2d 689 (3d Cir. 1973). These cases construed the identical phrase preceding the definition of "security" in Section 3 of the Securities Exchange Act, 15 U.S.C. 78c(10).

8 *Exchange Nat'l Bank* v. *Touche, Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976).

9 15 U.S.C. 77c(a)(3).

10 Securities Act of 1933, Section 5, 15 U.S.C. 77e.

11 *See Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Comm.*, 73d Cong., 1st Sess. 179 [hereinafter cited as *Hearings on H.R. 4314*] (statement of William C. Breed).

issued short-term commercial paper to finance current operational business expenditures of a seasonal or periodic nature, and that to require registration in these circumstances would be unduly burdensome.[12] In response to these comments, Congress in Section 3(a)(3) carved out a subcategory of "notes" that would be exempt from the registration requirements, but Congress did not alter the basic definition of "security". In other words, "notes" that qualify for the exemption from registration still fall within the definition of "security," and are therefore subject to the antifraud provisions of the Securities Act. Thus, even if the commercial paper that Bankers Trust is distributing does qualify for the Section 3(a)(3) exemption from the registration requirements, as it asserts,[13] this paper is still a "security" for purposes of the Securities Act.

Moreover, we have serious questions about whether the securities distributed by Bankers Trust qualify for the exemption from registration in Section 3(a)(3) of the Securities Act. The Commission has enunciated four criteria that must be present before commercial paper will qualify for the exemption.[14] The paper must be:

(1) prime quality paper;
(2) not ordinarily purchased by the general public;
(3) issued to facilitate well-recognized types of current operational business transactions; and
(4) eligible for discounting at Federal Reserve banks.

Based on the information that has been furnished to the Commission, it is unclear whether the commercial paper being

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12 *Id.* at 179-83; *Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 94-95, 120 (1933).

13 *See* Letter from James J. Baechle, Senior Vice President and General Counsel, Bankers Trust Co., to Neal L. Petersen, General Counsel, Board of Governors of the Federal Reserve System (Feb. 2, 1979).

14 Securities Act Release No. 4412 (Sept. 20, 1961).

sold by Bankers Trust has met all four criteria necessary for an exemption from registration.[15] For example, it appears that Bankers Trust is selling commercial paper to the general public, and thus has not complied with the second requirement of the Release. Bankers Trust advertises to prospective clients that it has "access to the retail investor through over 200 branch offices in New York State."[16] This statement implies that Bankers Trust is selling, or intends to sell, commercial paper to the general public. And, we share your concern about the potential for widespread distribution of this paper. It also appears that the third requirement concerning "current transactions" may not be met because the promotional literature of Bankers Trust suggests that issuers use the proceeds from the sale of commercial paper to invest in other securities.[17]

This application of the definitions from the Securities Act to the terms of the Glass-Steagall Act would not only provide a consistent definition of "security" for these two contemporaneous Acts, but also would comport with the Congressional concerns behind the Glass-Steagall Act as described later in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). While your position paper contends that these concerns have little or no relevance to third-party commercial paper activities of banks, we believe that there is a significant connection between the commercial paper activities of Bankers Trust and the nine specific "hazards" that you enumerate in your posi-

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15 *See Sanders* v. *John Nuveen & Co., Inc.*, 463 F.2d 1075 (7th Cir. 1972), and *Franklin Savings Bank* v. *Levy*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,389 (S.D.N.Y. 1975), where the courts found that commercial paper issued by corporations did not meet these four criteria.

16 Bankers Trust, *Commercial Paper Proposal: Bankers Trust Responds to Your Commercial Paper Needs* 3 (undated).

17 *Id.* at 5, 16. Securities Act Release No. 4412 specifically states that the "current transactions" requirement is not met if proceeds from the sale of commercial paper are used to purchase securities.

tion paper as underlying the passage of Sections 16 and 21 of the Glass-Steagall Act.

1. A commercial bank might invest its own assets in frozen or otherwise imprudent stock or security investments.

2. A commercial bank might be subject to new promotional and other pressures to shore up its securities affiliate through unsound loans or other aid.

The position paper appears to assume there is no possibility that imprudent investments might be made by a bank selling commercial paper. Instead, it seems to regard activities by banks in commercial paper as unquestionably prudent merely because they are inspected by bank examiners. However, Congress was very concerned that the promotional pressures and conflicts arising out of investment banking activities might detrimentally affect a bank's judgment regarding loans or investments in securities of particular issuers in which the bank also had a saleman's interest. *Camp,* 401 U.S. at 630-33. As pointed out by the Supreme Court, "[i]t was thought that the bank's saleman's interest might impair its ability to function as an impartial source of credit." *Id.* at 631 (footnote omitted), *citing* remarks of Senator Glass. Although banks originally conducted securities operations indirectly through securities affiliates, an interpretation permitting investment banking activities which potentially involve the same or similar abuses when conducted by banks directly would appear to permit form to triumph unjustly over substance. *Id.* at 629.

3. Public confidence in a commercial bank might be impaired should its affiliate perform poorly.

Commercial paper activities conducted directly by a bank, rather than indirectly through an affiliate, may in fact increase the risk that the public will lose confidence in the bank. As you point out, it may be true to some extent that public confidence in a commercial bank is "maintained through the examination process." However, to the best of our knowledge, bank exami-

nation procedures did not prevent the losses by even a single bank purchaser of Penn Central's commercial paper in 1970—despite the availability of public information which tended to indicate that the paper was of less than prime quality. *See, e.g., Penn Central Report, supra,* at 279, 289. To the best of our knowledge, there is also no examination procedure currently being employed to evaluate the soundness of commercial paper sold by a bank for an issuer. This is particularly important in light of the fact that purchasers of commercial paper from banks presumably rely at least as much as customers of broker-dealers upon the seller's prestige and reputation. *Id.* at 275. As the Supreme Court said: "Congress feared that the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence and restraint to the enterprise of selling particular . . . securities, and that this could not be done without that reputation being undercut by the risks necessarily incident to the investment banking business." *Camp, supra,* 401 U.S. at 632 (footnote omitted).

4. A commercial bank might make its credit facilities more freely available or make unsound loans to those companies in whose stock or securities its affiliate has invested or become otherwise involved.

Congress recognized that the pressure to sell a particular investment might create a risk that a bank would make unsound loans to companies in whose securities an affiliate has invested or become otherwise involved. *Id.* at 631. It would seem equally true that a bank, under the same promotional pressure to sell a particular issuer's commercial paper because of its substantial involvement, would yield to its saleman's interest and make its credit facilities more freely available, or make unsound loans, to those issuers.

5. A commercial bank's saleman's interest might impair its ability to function as an impartial source of credit.

Congress indisputably prohibited commercial banks from engaging in activities such as underwriting securities, other

than government and municipal securities,—whether those securities be commercial paper or otherwise. *Id.* at 629. A prohibition against commercial banks engaging in such investment banking activities would not in any way interfere with their proper commercial banking functions; it ensures and enhances the ability of commercial banks to perform their credit allocation function impartially, removed from the inevitable conflicts present in the context of the promotional pressures of investment banking.

6. Commercial bank depositors might suffer losses on investments they had made in reliance on the relationship between the bank and its affiliates.

Despite your assertions, there is no real assurance that commercial paper has been sold by banks only to "sophisticated investors who are able to evaluate the benefits and risks associated with the purchase of commercial paper." Indeed, we note that the information provided prospective and actual purchasers may be inadequate to permit a full evaluation of the risks involved, and appears to fall short of the information broker-dealers may furnish commercial paper purchasers. *See Penn Central Report, supra,* at 290.

7. A commercial bank might undercut its reputation for prudence and restraint through the sale of stock and securities by assuming the risks "necessarily incident" to the investment banking business.

As you point out, the business of dealing in short-term credit may generally be less risky than the business of investment banking, but it is clearly not riskless. Especially in light of the Penn Central case, we cannot agree with your contention that market forces can be relied upon to "dictate that only the most credit-worthy corporations issue commercial paper." Moreover, since the same strict credit analysis applicable to a bank's own commercial paper investments may not be applicable where the bank sells such paper to its customers, it risks the loss of public confidence if such paper turns out to be an unsound invest-

ment. And, Congress sought to ensure that public confidence in commercial banks was in no way jeopardized by investment banking. *Camp, supra,* 401 U.S. at 634.

8. A commercial bank might make loans to customers in order to facilitate the purchase of stock and securities of a speculative nature.

Regardless of whether or not commercial paper investments may be categorized as "speculative"—a judgment which depends on the current financial soundness of each particular issuer—it is indisputable that such investments involve some risk, and at least to that extent a bank risks a loss of public confidence when customers purchasing from it incur losses. Moreover, a bank's promotional interest in selling commercial paper for an issuer may interfere with the impartiality expected of banks making loans. An obvious temptation exists for a bank to favor allocation of credit to customers purchasing paper in which the bank has a direct promotional interest. Furthermore, this promotional interest may compromise the obligation of commercial bankers to render disinterested investment advice. In this connection, the Supreme Court noted with approval the following statement from the Act's legislative history:

> Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits.

Id. at 633 (footnote omitted), *citing* 75 Cong. Rec. 9912 (remarks of Senator Bulkley).

Letter, dated April 20, 1979

9. An affiliate of a commercial bank might use the bank's trust department to unload excessive holdings of securities.

Although some conflicts might be removed if a bank were prohibited from placing commercial paper which it sells in trust accounts which it manages, similar conflicts nevertheless may exist with respect to correspondent banks, which may feel pressure to place such paper in trusts which they manage. Also, promotional conflicts may exist not only with respect to trust accounts, but also with respect to all those customers to whom the bank owes a fiduciary duty or who in any manner rely upon the bank to render disinterested advice. If these conflicts are reduced by preventing trust accounts or any other customers from purchasing commercial paper of particular issuers which the bank serves, this would allow banks to engage in investment banking at the expense of their customers who may be deprived of desirable investment opportunities.

These are, in sum, our three major concerns with your letter and position paper on the commercial paper activities of Bankers Trust. We shall be pleased to give you any further assistance you may desire in this matter.

Sincerely,

/s/ RALPH C. FERRARA
Ralph C. Ferrara
General Counsel

Letter, dated June 26, 1979, from Ralph C. Ferrara to Neal Petersen

[Letterhead of SECURITIES AND EXCHANGE COMMISSION]

June 26, 1979

Neal L. Peterson, Esq.
General Counsel
Board of Governors of the
Federal Reserve Sytem
Washington, D.C. 20551

Dear Neal:

This responds to your letter dated June 14, 1979, and the enclosure, the revised draft of a paper by the Board's Legal Division entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis." We appreciate this second opportunity to offer our comments with respect to the Board's position concerning the distribution of commercial paper by commercial banks. In view of your strict time schedule, and because we believe that many of the points we made in our letter of April 20, 1979, remain applicable, our comments in this letter will be limited. And, we emphasize that this letter has not been formally reviewed by the Commission. We reiterate, however, that we would appreciate an opportunity to present a more comprehensive analysis after Commission review, if your position paper comes before the Board of Governors.

The revised draft concludes that commercial banks may, incidental to, or as part of, the banking business: (1) sell commercial paper as agent for the issuer, provided that such sales are "limited to purchasers to whom commercial banks normally sell participations in loans;"[1] (2) purchase and sell commercial paper for their own account, again provided that

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1 The revised draft, in turn, refers to "institutional purchasers" as those to whom banks normally sell loan participations.

the sales are limited to institutional purchasers; and (3) buy commercial paper as agent for the account of any customer, and sell commercial paper as agent for the account of any customer who is not the issuer of the paper.

Assessing whether a bank's commercial paper activities are consistent with the requirements of the Glass-Steagall Act requires, in our view, a two-fold inquiry. First, Section 16 of the Glass-Steagall Act, 12 U.S.C. 24, ¶ 7, requires resolution of the question whether a bank's commercial paper activities constitute an exercise of "such incidental powers as *** [are] necessary to carry on the business of banking ***." But an affirmative answer to this first question is not dispositive of the lawfulness of those activities—a bank's commercial paper activities must also be found to fall outside those areas of securities activities which are specifically prohibited to banks under Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24, ¶ 7 and 378.[2]

With respect to the latter inquiry, the revised draft employs the same mode of analysis and reasserts the same restrictive construction of the term "security" as did the initial draft. Accordingly, we continue to question the soundness of this approach. As we pointed out in our earlier comments, the staff's conclusion that the term "security," as used in Sections 16 and 21 of the Glass-Steagall Act, extends only to an "investment security" or a security that is "predominantly speculative in nature" appears at odds with both the language and legislative history of the Glass-Steagall Act.

The staff's revised position paper, like the earlier version, focuses on Congress' original use in 1933 of the term "invest-

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2 Such an approach proceeds from the well-settled canon of statutory construction that specific terms prevail over the general. *See, e.g.*, *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U.S. 222, 228-29 (1957); *Clifford F. MacEvoy Co.* v. *United States*, 322 U.S. 102, 107 (1944); *Ginsberg & Sons* v. *Dopkin*, 285 U.S. 204, 208 (1932); *Federal Trade Commission* v. *Manager, Retail Credit Co.*, 515 F.2d 908, 993-94 (D.C. Cir. 1975).

ment securities" in delimiting the scope of a bank's dealing and underwriting activities under Section 16 of the Glass-Steagall Act. But, as we noted in our earlier comments, two years after enactment of the Glass-Steagall Act, Congress amended Section 16 broadly to *prohibit* banks from dealing in or underwriting all "securities and stock"—not only "investment securities." By contrast, with respect to those securities which a bank is *permitted* to purchase for its own account, Congress in 1935 retained the narrower term "investment securities."

Moreover, neither the language of the original enactment of the Glass-Steagall Act in 1933, nor the amendments thereto in 1935, prohibit a bank from dealing in or underwriting only those securities which are "predominantly speculative in nature." And, we not persuaded, for the reasons we articulated in our earlier comments, that the legislative history of the Glass-Steagall Act supports assigning such a restrictive meaning to the term "securities and stock" under Section 16 of the Act. Similarly, the staff's reliance on the Board's letters to Congress during consideration of legislation which was to become the Securities Act of 1933 appears misplaced. While the Board urged Congress in that legislation to exclude commercial paper from the definition of a "security," Congress declined to adopt this approach. Rather, Congress, in Section 3(a)(3) of the Securities Act of 1933, exempted certain types of commercial paper from the registration requirements of the Act,[3] but defined a security under Section 2(1) to encompass commercial paper,[4] and extended the antifraud protections of the Act to

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3 Section 3(a)(3) of the Securities Act, 15 U.S.C. 77c(a)(3), exempts from registration "any note *** which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which have a maturity at the time of issuance of not exceeding nine months."

4 Thus, Section 2(1) of the Securities Act, 15 U.S.C. 77b(1), defines a security, among other things, to include any "note" or "evidence of indebtedness."

Because Congress defined "security" to include commercial paper, we do not find persuasive the revised draft's reliance upon testimony

transactions in all securities, whether or not exempt from registration.[5]

As we suggested in our earlier comments, any interpretation of the term "securities" under the Glass-Steagall Act must be made in light of, and preferably consistent with, that term's definition under the Securities Act, since both pieces of legislation were considered concurrently by Congress and were enacted within weeks of each other.[6] Of course, as we noted in our earlier comments, definitions under Section 2 of the Securities Act apply "unless the context otherwise requires,"

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on the Securities Act given by Senator Glass in 1933, urging that banker's acceptances and commercial paper be exempted from the definition of security. *Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). Indeed, if Senator Glass adhered to this view after passage of the Securities Act, it would seem logical that he would have attempted to incorporate into the Glass-Steagall Act a more restrictive definition of "security," so as to distinguish that term from the broader definition under the Securities Act.

5 *See* Securities Act of 1933, Sections 12(2) and 17(c), 15 U.S.C. 77*l*(2) and 77q(c).

6 In our earlier comments, we noted that the Board's staff, in construing the term "issue" for purposes of the Glass-Steagall Act, explained that "it is unlikely that Congress intended to give a content to the term as used in Glass-Steagall different from that given to the term in the Securities Act of 1933, which was enacted three weeks earlier." Federal Reserve Board Staff, *Commercial Bank Private Placement Activities* at 87 n.6 (1977). We noted further that the staff viewed the Securities Act's definition of "issue" to offer a "compelling analogy" to the meaning of that term under the Glass-Steagall Act. *Id.* at 89.

We do not perceive any basis for the distinction advanced in the staff's revised draft that definitions under the Securities Act which concern "securities activities, *e.g.*, 'issuing' and 'underwriting,' " may govern the meaning of terms used in both the Securities and Glass-Steagall Acts, but that the Securities Act definitions of "types of obligations" are not similarly applicable to the meaning of these terms under Glass-Steagall.

and, in light of this statutory proviso, courts have held that commercial paper arising from mercantile transactions is outside the definition of "security."[7] But, the mere fact that an instrument is called "commercial paper" is not determinative, since the application of the securities laws "turns on the economic realities underlying a transaction, and not on the name appended thereto." *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 849 (1975). In applying this approach, courts have consistently found commercial paper to constitute "securities" under the federal securities laws where they entail an investment feature and do not merely evidence a mercantile transaction.[8]

The *in pari materia* approach which we suggest for defining "security" under the Glass-Steagall Act by reference to the Securities Act is not undermined, as the staff's revised position paper asserts, by judicial decisions which treat bank time deposits as securities under the securities laws. *See, e.g., Garner* v. *Pearson,* 374 F. Supp. 591, 596 (M.D. Fla. 1974). Construing time deposits to be "securities" issued by a bank

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7 *See Great Western Bank & Trust* v. *Kotz,* 582 F.2d 1252 (9th Cir. 1976). *Cf. C.N.S. Enterprises, Inc.* v. *G & G Enterprises, Inc.,* 508 F.2d 1354 (7th Cir.), *cert. denied,* 423 U.S. 825 (1975); *McClure* v. *First Nat'l Bank,* 497 F.2d 490 (5th Cir. 1974); *Lino* v. *City Investing Co.,* 487 F.2d 689 (3d Cir. 1973) (cases construing "security" under the Securities Exchange Act of 1934).

8 *See, e.g., Exchange National Bank of Chicago* v. *Touche Ross & Co.,* 544 F.2d 1126 (2d Cir. 1976); *Sanders* v. *John Nuveen & Co., Inc.,* 463 F.2d 1075 (7th Cir. 1972); *Franklin Savings Bank* v. *Levy,* [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,389 (S.D.N.Y. 1975).

See also Securities Act Release No. 4412 (Sept. 20, 1961), where the Commission stated that commercial paper, in order to qualify for exemption from registration under the Securities Act, must be (1) prime quality paper, (2) not ordinarily purchased by the general public, (3) issued to facilitate well-recognized types of current operational business transactions, and (4) eligible for discounting at Federal Reserve banks.

under the Glass-Steagall Act has no disruptive effect on that statutory scheme. Sections 16 and 21 of the Glass-Steagall Act do not prohibit a bank from issuing its own securities, as opposed to dealing or underwriting the securities of others. Moreover, Sections 16 and 21 of the Glass-Steagall Act specifically refer to the receipt of deposits as a permissible activity of a commercial bank.[9]

As to the other inquiry under the Glass-Steagall Act—whether a questioned activity is incidental to the business of banking—the revised draft concludes that a bank's commercial paper activities, under certain limitations, would fall within the business of banking. However, we have serious reservations with respect to the specific approach adopted by the staff. Our reservations center on the adequacy of the restriction which the revised draft would impose upon sales of commercial paper by a bank as agent for an issuer and for its own account—namely, that such sales be limited to "institutional" purchasers to whom banks normally sell loan participations.

In the first place, as your revised draft acknowledges, loan participations themselves may constitute securities, subject to the antifraud provisions of the federal securities laws, particularly where multi-party, rather than two-party, loan participations are involved. Under such circumstances, the elements of a common enterprise and reliance by purchasers upon the enterpreneurial efforts of the lead bank may give rise to an investment contract. *See, e.g., Lehigh Valley Trust & Co.* v. *Central National Bank of Jacksonville*, 409 F.2d 989 (5th Cir. 1969). Accordingly, absent greater elaboration of current limi-

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9 Thus, Section 16 of the Glass-Steagall Act provides that a national banking association shall have power to exercise "all such incidental powers as shall be necessary to carry on the business of banking; * * * by receiving deposits * * *;" and Section 21 prohibits any organization "engaged in the business of underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes or other securities" from engaging at the same time "in the business of receiving deposits * * *."

tations on sales of the loan participations to which your revised draft refers, these participations themselves may raise questions under the Glass-Steagall Act.

Moreover, your draft does not define "institutional" purchaser or explain whether those institutions, in acquiring third party commercial paper, are under any constraints against selling that paper to general members of the public or other "non-institutional" purchasers. In this connection, we note that non-bank firms and individuals desiring to make short-term investments free of the interest rate restrictions which apply to traditional savings media are today major holders of commercial paper; these persons, absent appropriate restrictions, might well constitute the direct or ultimate purchasers of commercial paper handled by banks.[10] In addition, even assuming that limiting sales to current "institutional" purchasers could avoid Glass-Steagall problems, the revised draft contains no indication of whether banks could in the future sell commercial paper to non-institutional purchasers, if sales of loan participations are expanded to include such other purchasers.

As to a bank's purchase and sale of commercial paper for the account of its customers, the revised draft concludes that this activity is incidental to the business of commercial banking "[j]ust as section 16 of the Glass-Steagall Act authorizes national banks to purchase and sell securities and stock upon the order of and for the account of customers" [footnote omitted]. But the activities permissible under the Glass-Steagall Act on behalf of customers are circumscribed by the requirement that purchases and sales be "solely upon the order *** [of] customers." This language would appear to limit the discretion of banks in servicing the accounts of its customers and may also restrict certain forms of customer solicitations, such as advertising that promotes banks as "specialists" in the area of commercial paper.

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10 *See* R. Selden, *Trends and Cycles in the Commercial Paper Market* (1963); Note, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi. L. Rev. 362, 369 (1972).

Letter, dated June 26, 1979

Finally, we reiterate our conclusion that a bank's dealings in, and underwriting of, commercial paper raises policy concerns, identified by the Supreme Court in *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971), that prompted Congress to pass the Glass-Steagall Act. As discussed more fully in our earlier letter, Congress, in passing the Glass-Steagall Act, sought to insulate commercial banks from the "subtle hazards" that inevitably result when banks engage in securities dealings. These hazards, in our view, may be present where a bank distributes third party commercial paper among an undefined and unlimited number of "institutional" purchasers. Thus, a bank that distributes third party commercial paper, like a bank that underwrites an issue of equity stock, may jeopardize its reputation for prudence and restraint in promoting those securities, regardless of whether they may be characterized as more or less "conservative" investments. *Id.* at 637. Further, the salesman's interest which a bank has in a company's commercial paper might distort its credit decisions or lead the bank to make unsound loans either to the company, *id.* at 631, or to those who would use the proceeds to finance the purchase of securities promoted by the bank. *Id.* at 632. In short, we continue to question whether the promotional stake of a bank engaged in the underwriting, distribution, and sale of commercial paper will not be "destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system,"—evils which Congress sought to eliminate through passage of the Glass-Steagall Act. *Id.* at 634.

The foregoing summarizes our concerns with the revised staff position paper. Of course, we shall be pleased to provide any further comments which you may desire in this matter.

Sincerely,

/s/ RALPH C. FERRARA
Ralph C. Ferrara
General Counsel

Letter, dated June 28, 1979, From Neal L. Petersen, to James J. Baechle

[Letterhead of Board of Governors of the Federal Reserve System]

June 23, 1979

Mr. James J. Baechle
Senior Vice President and
General Counsel
Bankers Trust Company
280 Park Avenue
New York, New York 10015

Dear Mr. Baechle:

I am writing with regard to certain activities of Bankers Trust Company in the purchase and sale of third-party commercial paper. From your letters dated December 22, 1978, with enclosures, and February 1979, it is understood that Bankers Trust acts as agent for issuers in the sale of commercial paper, and, in connection with such activity, provides financial advisory services to issuers of commercial paper, provides extensions of credit at or near the commercial paper rate to issuers of commercial paper, and purchases and sells commercial paper in the secondary market. I have concluded that it is incidental to the business of commercial banking for a commercial bank to purchase commercial paper for the account of any customer and to sell commercial paper for the account of a customer who is not the issuer of the paper as agent of the customer, and that it is the business of commercial banking for a commercial bank to sell commercial paper as agent of the issuer of the paper and to purchase and sell commercial paper for the bank's own account, provided that the sales as agent of the issuer of the paper and for the bank's own account are limited to purchasers to whom commercial banks normally sell participations in loans. I have further concluded that such activities are not prohibited by the Glass-

Steagall Act. The bases for these conclusions are discussed in "Commercial Paper Activities of Commercial Banks: A Legal Analysis," a copy of which is enclosed.

In the February 2, 1979, letter, you state that all commercial paper for which Bankers Trust acts as agent of and financial advisor to the issuer is exempt from the registration requirements of the Securities Act of 1933 by section 3(a)(3) of that act. Section 3(a)(3) of the Securities Act of 1933 as interpreted by the Securities and Exchange Commission and the courts exempts from the registration and prospectus requirements of that act only prime quality, negotiable paper that is issued to facilitate well-recognized types of current operational business requirements, is of a type that is not ordinarily advertised for sale to and purchased by the general public, has a maturity at the time of issuance of not exceeding nine months, and is of the type eligible for discount at a Federal Reserve Bank. In the promotional literature regarding the commercial paper activities of Bankers Trust, the class of potential purchasers of the commercial paper that Bankers Trust distributes is described as including a very large, diverse group of over 3,000 institutional purchasers in a variety of economic sectors and geographical regions, as well as retail purchasers. To constitute commercial paper, the paper must be sold to sophisticated purchasers and not to members of the general public. Further, to constitute the business of commercial banking, sales of commercial paper by a commercial bank as agent of the issuer of the paper and for the bank's own account should be limited to purchasers to whom commercial banks normally sell participations in loans. Accordingly, Bankers Trust must conform its commercial paper activities to this limitation.

In the December 22, 1978, letter, you state that Bankers Trust does not place the commercial paper of an issuer in accounts managed or advised by the trust department of Bankers Trust. Such practice is necessary to avoid possible conflicts of interest and should continue.

Letter, dated June 28, 1979

You state in the December 22 letter that Bankers Trust acts as agent for its parent bank holding company in the solicitation of orders for and in the sale of commercial paper issued by the holding company. The question whether such activity is an appropriate banking practice is not an issue addressed in the enclosed legal analysis of commercial paper activities of commercial banks.

If you have any questions regarding the conclusions of this letter or the enclosed legal analysis, you may contact me (202-452-3293) or Mr. John Walker (202-452-2418) of my staff.

Very truly yours,

/s/ NEAL L. PETERSEN
Neal L. Petersen
General Counsel

Enclosure

Excerpt from "Commercial Paper Activities of Commercial Banks, A Legal Analysis," Legal Division, Board of Governors of the Federal Reserve System

COMMERCIAL PAPER ACTIVITIES OF COMMERCIAL BANKS: A LEGAL ANALYSIS

Legal Division

Board of Governors of the Federal Reserve System

June 28, 1979

[material deleted]

of any customer and to sell commercial paper for the account of a customer who is not the issuer of the paper as agent of the customer, and it is the business of commercial banking for a commercial bank to sell commercial paper as agent of the issuer of the paper and to purchase and sell commercial paper for the bank's own account, provided that the sales as agent of the issuer of the paper and for the bank's own account are limited to purchasers to whom commercial banks normally sell participations in loans. Such activities do not violate sections 16 and 21 of the Glass-Steagall Act and are appropriate activities for commercial banks.

Letter dated February [illegible]0, 1980, from Ralph C. Ferrara to Theodore E. Allison

[Letterhead of Securities and Exchange Commission]

Theodore E. Allison
Secretary
Board of Governers of the
  Federal Reserve System
20th & C Streets, N.W.
Washington, D.C. 20551

Dear Mr. Allison:

This Office has been advised that the Board of Governors of the Federal Reserve System (the "Board") will review the conclusion of the Board's General Counsel that the sale of third party commercial paper by Bankers Trust Company, if restricted to purchasers to whom commercial banks normally sell loan participations, is incidental to the business of banking and does not violate the Glass-Steagall Act.

As you may be aware, Neal L. Petersen, General Counsel to the Board of Governors, sent this Office, under covering letters dated April 12, 1979 and June 14, 1979, copies of (1) draft letters to Bankers Trust Company and (2) draft position papers of the Board's Legal Division entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis," and requested comments on these documents. In response to these requests, this Office submitted comment letters dated April 20, 1979 (Exhibit A), and June 26, 1979 (Exhibit B). We emphasized in each submission that the Commission had not formally reviewed this matter, and requested an opportunity to present additional comments, after formal Commission review, if the Board of Governors determined to review the staff's action.

The Commission has authorized me to inform you that it has reviewed, and concurs with, the letters of this Office dated April 20, 1979 and June 26, 1979. The Commission respect-

fully requests that these letters be presented to the Board of Governors for their consideration.

Sincerely,

/s/ RALPH C. FERRARA
Ralph C. Ferrara
General Counsel

Memorandum, dated May 8, 1980, to Files from Mr. Ashton and Ms. Fein Re: Meeting with Bankers Trust Officials

May 8, 1980

Files Meeting with Bankers Trust

Mr. Ashton and Ms. Fein officials.

On March 20, 1980, we met in New York with officials of Bankers Trust Company (Mr. James Baechle, General Counsel, and Mr. Garrett Thunen, Senior Vice President) to discuss Bankers Trust's commercial paper sales activities. Also present at the meeting were Robert O'Sullivan, Lawrence D. Fruchtman, and Al Toss of the New York Reserve Bank, and John Barnum and Jennifer Sullivan of the firm of White and Case, counsel to Bankers Trust. The purpose of our visit was to update information submitted by Bankers Trust on its commercial paper activities and to observe their commercial paper operations in preparation for Board review of petitions by A. G. Becker, Inc. and the Securities Industry Association challenging such activities. The following findings are based on our conversation with the Bankers Trust officials, and will be confirmed to the extent possible by Reserve Bank examiners during a general examination of the Bank commencing on April 1st:

I. *Organization*

[Material deleted]

II. *Description of Transactions*

1. Bankers Trust has sold commercial paper for issuers, with an average of about at present.
2. of the issues are split with another dealer.
3. The average note sold by Bankers Trust is approximately $1 million. The minimum denomination Bankers Trust will sell is $100,000. Maturities of notes sold average 60 days.

Memorandum, dated May 8, 1980

III. *Issuers*

[Material deleted]

IV. *Sales Activities*

[Material deleted]

V. *Purchasers*

[Material deleted]

2. Bankers Trust does not sell commercial paper to its trust department's discretionary accounts. If a Bankers Trust trust customer wishes to purchase commercial paper that Bankers Trust is selling as agent, however, the sale is made through the trust department.

3. Bankers Trust sells commercial paper mainly to corporations, other banks, including correspondent banks for their own account, and trust and pension funds. Bankers Trust does not sell to individuals. Purchasers also buy other short term investments sold by Bankers Trust.

4. The number of purchasers for each issue averages about 5 and usually no more than 15.

5. As far as Bankers Trust was aware, all purchasers were final investors. No resale of paper was contemplated.

6. Purchasers are usually, but not always, Bankers Trust customers.

7. There is no evidence that purchasers used borrowed funds to buy the commercial paper.

VI. *Conflicts of Interest*

[Material deleted]

cc: Messrs. Petersen, Mannion, Schwartz & Plotkin

Transcript of Board Deliberations on August 22, 1980 concerning SIA Petition [R. 647-658]

BOARD MEETING—FRIDAY, AUGUST 22, 1980
Agenda Item #4

Discussion regarding consideration of the petitions for review of activities for a State member bank with respect to commercial paper.

VOLCKER: Well, let me just say we are recording this discussion of this enforcement action brought with respect to Bankers Trust, and we do think that the meeting is properly closable, but a good deal of the discussion may be usually available for publication within a short period of time so long as those elements that are of concern with respect to a closed meeting could be deleted, and we're proceeding on that basis. I think on that understanding, why don't you proceed, Mr. Counselor.

PETERSEN: Thank you, Mr. Chairman. Mr Ashton of my staff will give the presentation on this matter.

ASHTON: Mr. Chairman, when this matter was last considered by the Board, some members of the Board expressed concern that commercial bank involvement in the sale of third party commercial paper may, at least in some circumstances, give rise to unsafe practices or potential conflicts of interests. Subsequently, at the request of Governor Partee, the Examination Council apponted a task force to consider the drawing up of guidelines that would govern in general the sale of third party commercial paper by banks. The task force has met and is presently considering drawing up such guidelines. The task force has met and is presently considering drawing up such guidelines. In view of the fact that the petitions by the Securities Industry Association and by A. G. Becker have been pending for a substantial period of time. And in view of the fact that the implementation of any guidelines drawn up at the Exam Council would necessarily involve some further delay, we believe that it's advisable at this time to act on the SIA and

A. G. Becker petitions without further delay. As explained in a previous memorandum, we believe [material deleted]

PETERSEN: When we say expand, we mean not change the nature of the activity beyond what they are presently doing, but we don't mean they have to confine their customers, for example, to what they are already doing.

SCHULTZ: When you say no other State member bank, you also mean bank holding companies as well?

ASHTON: I assume that that probably would apply, but we're not aware of any bank holding companies that are even interested in this. The only interest we've heard is from banks. They're doing it through their dealer departments.

PLOTKIN: That would be a new activity, Governor Schultz, which is not on the permitted list.

PARTEE: The difficulty here is we don't have the authority to specify this for national banks. We don't have the authority to specify what the restraint should be on the activity on the part of national banks. That's why I wanted to refer the matter to the Examinations Council.

VOLCKER: But if a bank can do it, can't a holding company do it? The argument here is that this is a banking function. Can't a holding company . . . . .

PETERSEN: They would have to apply to do it as a new activity.

VOLCKER: But would we have any banks . . . . . I guess I don't understand that. Are we in the business of prohibiting a holding company from doing something that the bank itself can do?

PETERSEN: No, we're not in that business.

VOLCKER: Do we ever do it? Do we have any grounds for doing it?

PETERSEN: Well, yes, I suppose holding companies don't accept deposits and issue checking accounts and things like that so there could be some distinction if a holding company chose to enter into this activity, they would either have to file an application under section 4(c)(8) or possibly make the argument it would be permitted under 4(c)(5), which is a statutory provision that says, basically, that if a national bank is specifically or a bank is specifically authorized to do something the holding company would be able to . . . .

VOLCKER: Well, that's what I had in mind. Why wouldn't they argue that?

PETERSEN: It's possible they would.

VOLCKER: I think offhand I would find it very difficult to say that a holding company couldn't do this if a bank could do this.

PARTEE: Well, if a holding company were to come to us I'm inclined to think that you're correct that we would determine that since this must be closely related to banking because this is what banks do.

VOLCKER: Which is the whole issue to this legal argument.

PARTEE: That's right. But no one has come to us.

ASHTON: And we don't have any indication that they will in the near future.

PARTEE: But in the meantime . . . .

VOLCKER: They actually have to come to us even if they argue this other provision applies?

PETERSEN: It would be the better part of valor. Technically, you don't need an application, I believe, under section 4(c)(5).

MANNION: 4(c)(5) only allows you to acquire shares, doesn't allow you to engage in the activity.

VOLCKER: How much interest do we have among other banks in this matter?

Transcript, August 22, 1980

PETERSEN: Well, as far as any direct contact with the Board on this matter, I am not aware of any specific request. I understand but I can't say with certainty that there are some national banks that are interested in this activity.

ASHTON: Well, Bankers Trust told us that they had heard in the street that Citibank was thinking of doing it and I think staff may have gotten a couple of phone calls—one from Mellon in Pittsburgh and there may have been a couple of others—just inquiring generally about the status of the Bankers Trust matter.

PARTEE: I think it might develop with a few big banks, Paul, as an extension of the service of money management.

VOLCKER: Well, I'm a little surprised it hasn't developed. This is why I asked the question—why hasn't it developed?

PETERSEN: I think a number of institutions may be waiting for the final resolution of this particular proceeding before committing any resources to this activity with the possible exception of Citibank and maybe a couple of others.

VOLCKER: Well, the way this thing has been structured, we got a legal question and we've got a policy question. I take it you think there's a high probability that whatever way our decision goes, it will be contested.

PETERSEN: From all indications, Mr. Chairman, I would expect that it would be challenged.

VOLCKER: Well, I have a few questions about the implication and strategy involved assuming that the thing is going to be challenged.

[material deleted]

However, I have not seen the SEC brief and briefs tend to be persuasive when you read one side of it and then the other side tends to be persuasive too. What do they say on that point?

Transcript, August 22, 1980

PETERSEN: Well, Mr. Ashton, I want to comment that the SEC's arguments were reflected in the original memorandum to the Board.

ASHTON: Their argument is based on a definition in the Securities Act. The Securities Act of 1933 defines "security" to include all notes but then exempts commercial paper.

(VOLCKER OUT BRIEFLY.)

ALLISON: Could we wait a minute. Does any other Board Member have something to ask in the meantime?

PARTEE: Well, I did want to ask about the legal argument—about the question of the propriety of the activity so far as it's now engaged in by Bankers. As I understand it, first of all the accusations. They don't take these notes into account and then sell them out but they sell them on behalf of the corporation?

ASHTON: That's what they say but there are two modifying conditions. First of all, they told us that the parent holding company does purchase paper that the bank is selling for the holding companies own account. Now we haven't been able to connect that up to show that it's like an underwriting. The holding company may be holding it as a permanent investment but they said it's possible that the holding company may have sold the paper out of the holding company's portfolio which makes it look sort of like an underwriting. The other thing that qualifies it is Bankers Trust will make a loan at the commercial paper rate for a portion of the unsold proceeds of the paper that the bank is trying to sell.

PARTEE: Well, that is they undertake to sell the paper on the best efforts basis to the extent that it isn't sold within whatever time frame that is agreed to why they will fund the corporation with a loan.

ASHTON: With a loan at the commercial paper rate and I think it's at the end of the selling day.

Transcript, August 22, 1980

PARTEE: At the end of the selling period.

PLOTKIN: They make no commitment to the issue that they will sell. They state that if there is any unsold amount, they will then advise the issuer and the issuer will ask whether they will purchase the unsold amount. It is done by the same group—operating people—in the bank. They say they take the paper back—if they make a loan, they take the paper back as collateral and then may sell it out as the market permits in the next few days and you do have the question though that they can still purchase the same paper for their own investment account and then when it gets into the question that we did find out that they purchased some of the paper in the holding company they did state that it was their policy that they would apply the bank's legal lending limit to any purchase of paper whether in the investment portfolio of the bank or in the bank holding company.

PARTEE: Well, you say they purchase it for their investment account but in fact, they purchase it as a loan and then shows in commercial loans for the enterprise and that's particularly with blind statements. But the total—the lending limit in their view would apply to what—to their total holding or to the total of the issue?

PLOTKIN: To their total holding but not to the total of the issue.

PARTEE: And they have no responsibility, implied or otherwise, to have to buy back these notes from the market.

PLOTKIN: That is their view.

PARTEE: And that's stated? Is it stated?

PLOTKIN: I think that was stated to us.

PARTEE: Well, I mean is it stated in the papers and stuff? Was it understood by investors and by the issuing corporation?

PLOTKIN: In the investment—commercial paper being short-term obligations—there is a secondary market but a very small secondary market for commercial paper. I think you have in your memo, Rich, that they did state to us that if somebody did want a purchaser of commercial paper—did want to resell to them—they would then consider it at that time.

ASHTON: That's right, as an accommodation to the purchaser.

VOLCKER: I thought I saw some place in here that they did occasionally do that.

PLOTKIN: They did occasionally do that.

ASHTON: Apparently that's common practice in the commercial paper business.

VOLCKER: Who is on their customer list?

PARTEE: I was going to ask that too.

ASHTON: They supplied us with the names of 9 companies for which they had . . .

VOLCKER: For which they issue. I saw that but . . .

ASHTON: To whom do they sell?

VOLCKER: Who do they sell to?

PLOTKIN: They're customers who generally deal in short-term obligations. It's their short-term, it's the money market desk . . . .

[material deleted]

VOLCKER: I am not clear at this point on the non-legal aspect, just the policy aspect of this. What kind of a recommendation do we have from Supervision and Regulation?

RYAN: Well, Mr. Chairman,

[material deleted]

Transcript, August 22, 1980

SCHULTZ: That's where we seem to keep coming back to. The simple reason that it gets hard as hell to find any reason to turn it down on a legal basis.

PARTEE: Well, I think the legal case is pretty persuasive and that it is not a security.

SCHULTZ: I think it is too and given that it's difficult to find any good sound reason for turning it down but you do have these nagging worries and so you say let's button it up as best we can to protect against possible dangers in the future.

GRAMLEY: Well, the Legal Division did make that point that is regard to public policy issue at the moment. There's no reason for thinking that there's anything that's adverse to public interest in what's going on now. That does not seem to impose any significant problems. Isn't that correct?

PETERSEN: With respect to Bankers Trust?

GRAMLEY: Yeah. I don't think that basis is open to us for denial at this point. It seems to me that on both grounds—both legal grounds and policy grounds—the only option to us is to go ahead and permit the bank to engage in this activity and then cover ourselves with a set of specifications as what constitutes appropriate behavior in this market.

VOLCKER: I can't say as I don't think we don't have an option because there are lots of things where you could say I don't see any present abuse but I'm worried enough about the future so I'm going prohibit—

[material deleted]

PETERSEN: That would be something for everybody.

VOLCKER: I'm not suggesting we propose a change of law at this point unless we feel more strongly than we probably do. But . . .

PARTEE: I don't see any basis for it right now, Paul, but it might prove to be necessary.

VOLCKER: But then we've got some concerns about the desirability of this from our safety and soundness standpoint as it might be expanded. We may not have any concerns about Bankers Trust in the long run, I think that we don't. Therefore, we want to write in effect the regulation or a guideline—I'm not sure we're in a position to be fully satisfied about that guideline at the moment and therefore make a decision. We can make a decision to the extent of saying that's the direction we want to go but do we need something before us in the way of a guideline before we say this . . . .

PETERSEN: Mr. Chairman, bear in mind that this particular decision you have to make here today is whether or not we issue a cease and desist order against Bankers Trust to cause them to stop in their tracks so I think the approach of saying no, you don't have to stop in your tracks but don't change the nature of your activity and be on notice that you and other institutions may be subject to some further guidelines and restrictions on this activity in the future would be the proper way to go.

VOLCKER: I don't think that we want to say, I don't think that everything they're doing now is fine. That may be the case but I'm not sure we want to commit ourselves to that right at the moment.

PETERSEN: Well, we wouldn't . . . .

VOLCKER: I mean these questions of

PARTEE: Well, it'll take a little while, Paul, to get a proposed guideline back to the Board because of course the Board has no authority to impose any guidelines on national banks and therefore it's got to work through the Examination Council route in order to be effective.

VOLCKER: Well, what we're saying and this may not be any different from what you say but I think it's slightly different in tone from this thing I saw that on the issue presented to us of

the legal—cease and desist—in effect on the legal grounds that they're violating the Glass-Steagall Act we reject. We are more broadly examining the issue from the safety and soundness standpoint and we're not asking Bankers Trust to do anything at the moment but we are engaged with other agencies and intend to develop some guidelines which may or may not permit them to do what they're now doing. They don't have to change anything now but we are looking at it from that standpoint and in cooperation with the other agencies.

PETERSEN: That's basically what I had in mind.

VOLCKER: I got the tone from what you had written that everything they're doing now is okay.

PARTEE: And I think that's a good point to make, that we don't necessarily approve every jot and tittle in this operation.

VOLCKER: In fact it's approved on an interim basis because we're not doing anything about it. We're kind of warning them that we're going to come up with some guidelines that may in a fact affect the way they've been doing things.

PARTEE: And that can be reflected in the letter without much trouble.

VOLCKER: And I think you've got some suggestions as how to proceed on the guidelines and you come back to us on that issue when you're ready. I guess we probably need a formal vote on this one. I don't know whether the question has been defined clearly enough. I think the specific question is no cease and desist on the grounds of the Glass-Steagall Act and we're taking no other action at the moment. The rest of it is in the nature of more informal guidance and expression of our intention to look at this thing carefully from the safety and soundness standpoint as part of the bank regulatory function rather than as part of Glass-Steagall.

Transcript, August 22, 1980

PETERSEN: Mr. Chairman, perhaps Mr. Ashton can expand on a couple of other technical issues that are before the Board in terms of the formal hearing request as I recall.

ASHTON: The request by counsel for A.G. Becker for oral argument, not a hearing, oral argument before the Board which was just reiterated recently and we have recommended that that request be denied since the issue was essentially a legal one that has been covered adequately in the voluminous pleadings that have been submitted over the last 18 months and we don't believe that oral argument before the Board would serve any purpose and we're recommending that that additional request be denied at the same time the petition for cease and desist order are also denied.

VOLCKER: I assume that we are following that.

PARTEE: It seems to me that we are thoroughly steeped at this point with issues we've had.

VOLCKER: I think that we'll have a vote on this.

ALLISON: Vice Chairman Schultz?

SCHULTZ: Yes

ALLISON: Governor Partee?

PARTEE: Yes or no?

SCHULTZ: The recommendation asserts that we not issue a cease and desist order and I'm favoring the recommendation.

VOLCKER: And that we not have an oral hearing.

PARTEE: I agree.

GRAMLEY: I agree.

VOLCKER: Yes.

Letter of the Board, dated September 26, 1980, in response to petitions concerning sale of third party commercial paper by Bankers Trust Co.

[Letterhead of Board of Governors of the Federal Reserve System]

John M. Liftin, Esq.
Rogers & Wells
1666 K Street, N.W.
Washington, D.C. 20006

Harvey L. Pitt, Esq.
Fried, Frank, Harris,
Shriver & Kampelman
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037

Gentlemen:

This is in reference to petitions submitted to the Board by the Securities Industry Association (the "SIA") and A.G. Becker, Incorporated ("A.G. Becker") requesting that the Board prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling commercial paper issued by companies not related to the bank ("third party commercial paper"). The SIA and A.G. Becker allege, among other things, that Bankers Trust's sale of third party commercial paper violates the Glass-Steagall Act and must be prohibited by the Board.

In July 1978, Bankers Trust was reported to have placed several issues of third party commercial paper on behalf of certain corporate issuers. Shortly thereafter, the SIA, a national trade association of securities brokers, dealers, and underwriters, and A.G. Becker, one of the recognized dealers in commercial paper, requested Board staff to review the legality of such activities. On June 28, 1979, after the submission of written comments by interested parties, including the General Counsel of the Securities and Exchange Commission

("SEC"), the Board's Legal Division issued a legal analysis dealing in general with commercial paper activities by commercial banks. The analysis found that it is the business of commercial banking for a commercial bank to sell third party commercial paper as agent of the issuer or for the bank's own account, provided that such sales are limited to institutional purchasers to whom commercial banks might in the normal course of business sell participations in loans. The opinion also concluded that such activities did not violate the Glass-Steagall Act. By letters dated June 29, 1979, the General Counsel advised the SIA and A.G. Becker that the Board had not considered the matter but that the Legal Division would recommend that the Board do so if those organizations requested.

On July 26, 1979, the SIA submitted to the Board a petition requesting that the Board formally review the matter and order Bankers Trust to cease and desist from all its third party commercial paper activities. By letter dated January 31, 1980, A.G. Becker made clear that it wished its previous submissions presented to the Board. In addition, by letter dated February 20, 1980, the General Counsel of the SEC stated that the Commission had reviewed and concurred with the views expressed by the SEC's General Counsel in his comments to the Board's General Counsel on these issues.

In requesting that the Board review the selling of commercial paper by Bankers Trust, the SIA and A.G. Becker claim that Bankers Trust is engaged in underwriting or dealing in a security in violation of the Glass-Steagall Act and that such activities will result in the kinds of risks to the bank and potential conflicts of interest that the Act was intended to eliminate. In addition, A.G. Becker claims that the selling of third party commercial paper by commercial banks will have other adverse effects that warrant prohibition of the activities on public policy grounds. The comments of the SEC generally agree with the Glass-Steagall Act arguments of the SIA and A.G. Becker.

Letter, dated September 26, 1980

In acting on the petitions of the SIA and A.G. Becker, the Board has considered the legal analysis of the Board's Legal Division concerning commercial paper activities of commercial banks as well as the submissions of all the interested organizations, including those of the SIA, A.G. Becker, Bankers Trust, and the SEC, and information on Bankers Trust's commercial paper activities obtained from officials of the bank.

The Board has determined to deny the petitions of the SIA and A.G. Becker to the extent such petitions allege that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy.

The Board has concluded that, with respect to the alleged violation of the Glass-Steagall Act, the stronger argument is that the financing instrument commonly referred to as commercial paper is not a "security" within the meaning of the Glass-Steagall Act. The restrictions of the Act against underwriting and dealing in securities thus do not apply to such an instrument. The Board has also determined that the general considerations of public policy advanced by A.G. Becker, such as allegedly unfair competitive advantages by banks in selling commercial paper, do not at this time warrant prohibition of Bankers Trust's commercial paper activities.

In the Board's view, however, the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, potential unsafe or unsound banking practices. Accordingly, the Board, in cooperation with the other bank regulatory agencies, has initiated the process of developing guidelines designed to prohibit potential unsafe or unsound practices in the sale by a bank of third party commercial paper. The Board, therefore, is taking no action regarding petitioner's contentions of dangers to Bankers Trust and potential conflicts of interest and will consider these issues in the context of the Board's consideration of such general guidelines.

Letter, dated September 26, 1980

Finally, the Board finds that the issues involved in these petitions are primarily legal in nature and have been adequately addressed in the many written submissions of the petitioners, the SEC, and Bankers Trust. Accordingly, the request by A.G. Becker for oral argument before the Board on this matter is denied.

The reasons for the Board's actions are set forth in detail in the accompanying Statement Regarding Petitions To Initiate Enforcement Action.

Very truly yours,

(signed) THEODORE E. ALLISON
Theodore E. Allison
Secretary of the Board

cc: William C. Knox, Jr., Esq.
John W. Barnum, Esq.
James J. Baechle, Esq.
Ralph C. Ferrara, Esq.

Federal Reserve System, *Statement Regarding Petitions to Initiate Enforcement Action*, dated September 26, 1980

STATEMENT REGARDING PETITIONS TO INITIATE ENFORCEMENT ACTION

The Securities Industry Association (the "SIA") and A.G. Becker, Incorporated ("A.G. Becker") have requested the Board to prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling commercial paper issued by companies not related to the bank ("third party commercial paper"). The SIA and A.G. Becker allege that Bankers Trust's sale of third party commercial paper violates the Glass-Steagall Act, which generally prohibits banks from underwriting or dealing in securities. A.G. Becker also contends that considerations of public policy militate against permitting Bankers Trust from selling third party commercial paper.

Bankers Trusts' Sales Activities

Commercial paper refers to prime quality, negotiable, usually unsecured short-term promissory notes issued by business organizations to meet part of their short-term credit needs.[1] Commercial paper is offered and sold to sophisticated purchasers, rather than to the general public, through dealers or directly by the issuer. Because commercial paper is usually unsecured, issuers are generally large, well-known, and financially strong businesses. Most commercial paper has an initial maturity of 60 days or less and the paper sold by dealers is issued in denominations usually ranging from $100,000 to $1 million or more. Purchasers of commercial paper are mostly large institutions with idle short-term funds to invest. Commercial paper is considered relatively risk-free; interest rates on

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1 For a more detailed description of the commercial paper market *see* Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977) [hereinafter cited as "Hurley"] and Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

commercial paper are usually slightly above the rates on short-term United States government obligations, such as Treasury bills. The proceeds of commercial paper traditionally have been used for current or seasonal needs.

Bankers Trust represents that it is selling third party commercial paper only as the agent of the issuer and that the bank is not, like the commercial paper dealers, acting as a principal in such sales. Bankers Trust does not purchase, or make any commitment to purchase, the commercial paper the bank sells as agent. On some occasions, however, Bankers Trust extends credit (without any prior commitment), at or near the commercial paper rate, to issuers of paper sold by the bank in an amount representing a small portion of the unsold amount of the issue. The notes representing such loans may subsequently be sold. The bank's parent holding company has purchased for its own account commercial paper sold by the bank.[2]

Bankers Trust states that it does not tie the use of its other services to its commercial paper selling services and does not offer special inducements to issuers using such services. Bankers Trust sells only prime quality commercial paper of issuers that have the highest rating from at least one of the rating services that rate commercial paper issuers.

The customers to whom Bankers Trust sells commercial paper are usually part of Bankers Trust's established base of institutional investors that regularly purchase from the bank other short-term instruments in which the bank deals. Bankers Trust does not sell to individuals or to its trust department accounts.

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2 The bank also provides financial advice to issuers with regard to the issuance of commercial paper and serves as settlement agent for purchases of commercial paper. None of these activities has been directly challenged. Bankers Trust also sells as agent commercial paper issued by its own parent holding company. The Legal Division's analysis expressed no opinion on this activity and it is not involved in the present petitions.

Statement Regarding Petitions to Initiate Enforcement Action

The Glass-Steagall Act Issues

The Banking Act of 1933 contains four provisions (collectively referred to as the Glass-Steagall Act) that restrict participation by banks and affiliates of banks in specified securities activities. The provisions involved here are sections 16 and 21 of the Act, the provisions that apply to banks.[3] Section 16 provides in relevant part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock. 12 U.S.C. § 24 Seventh.

Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335, provides that State member banks are subject to the limitations of section 16 with respect to dealing in securities.

Section 16 carves out an exception to the general prohibition against involvement with securities by providing that national banks (and consequently State member banks) may purchase for their own account "investment securities" as defined in the statute.[4] "Investment securities" are defined by section 16 generally as marketable debt obligations commonly known as investment securities under such further definition prescribed by the Comptroller of the Currency. The Comptroller's regula-

3 Section 20 of the Act, 12 U.S.C. § 377, prohibits affiliates of banks from "engaging principally in the issue, flotation, underwriting, public sale or distribution" of securities. In addition, section 32 of the Act prohibits member banks from having director, officer, or employee interlocks with companies "primarily engaged" in the securities business.

4 Section 16 makes a further distinction with respect to investment securities. Banks may *underwrite* and *deal in* (as well as purchase for their own account) certain kinds of investment securities: obligations of the United States, general obligations of states or political subdivisions of states, and obligations of or guaranteed by certain government agencies.

tion, 12 C.F.R. § 1.3(b), defines "investment security" as a marketable debt obligation "commonly regarded as an investment security" and not "predominantly speculative in nature."

Section 21 of the Glass-Steagall Act provides that it is unlawful

> For any person, or . . . organization, engaged in the business of issuing, underwriting, selling, or distributing, . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time . . . in the business of receiving deposits. 12 U.S.C. § 378(a)(1).

Section 21 further provides that its restrictions do not prohibit any bank from "dealing in, underwriting, purchasing, and selling investment securities, or issuing securities" to the extent such activities are permissible under section 16.

Thus, both section 16 and section 21 recognize a distinction between "investment securities" and other kinds of securities. Banks in general may invest in, *but not* underwrite or deal in (with limited exceptions), investment securities; banks are barred from issuing, purchasing for their own account, underwriting, or dealing in securities that do not qualify as investment securities.[5]

The contentions of the SIA and A.G. Becker that Bankers Trust is violating these statutory prescriptions are based on the contentions that (1) commercial paper is a "security" for purposes of the Glass-Steagall Act and (2) Bankers Trust's selling activities constitute the forbidden underwriting and dealing in securities. Additionally, the SIA and A.G. Becker claim that the selling of third party commercial paper gives rise to the kinds of abuses and hazards identified in the Supreme Court's 1971 analysis of the Act in *Investment Company Institute* v. *Camp*, 401 U.S. 617. The Securities and Exchange Commission ("SEC") has submitted to the Board the SEC's views on the issues raised by petitioners.

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5 Under section 16, however, banks may perform certain *brokerage* activities—purchase or sale solely on the order of a customer—with respect to any securities.

Statement Regarding Petitions to Initiate Enforcement Action

A. *Commercial Paper as a "Security" under the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC advance three arguments in support of the claim that the commercial paper being sold by Bankers Trust is a "security" within the meaning of the Glass-Steagall Act: (1) commercial paper consists of marketable debt instruments and therefore constitutes an "investment security" as defined in section 16; (2) even if commercial paper is not an "investment security", commercial paper is a security because it consists of "notes" as specified in section 21; (3) commercial paper is a security for purposes of the Securities Act of 1933 and accordingly must be considered such for purposes of the Glass-Steagall Act, which was passed twenty days after the Securities Act.

Based on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a "security" within the intendment of the Glass-Steagall Act.

"*Investment securities*." In interpreting the meaning of the Glass-Steagall Act, the starting point must be the language of the statute itself.[6] Although each of the four Glass-Steagall Act provisions refers to activities with regard to "securities," none of these provisions, nor any other section of that Act, contains a precise definition of the term "securities." As noted above, however, both section 16 and section 21 create a distinction between investment securities—obligations that a member bank may purchase for its own account but in general may neither underwrite nor deal in—and other securities—obligations with which banks may have no involvement (except for permissible brokerage activities).

"Investment securities" are defined in section 16 as follows:

> *marketable obligations*, *evidencing indebtedness* of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures *commonly*

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6 *See, e.g., Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11, 16 (1979).

> *known as investment securities under such further definition* of the *term . . . as may by regulation be prescribed by the Comptroller of the Currency.* 12 U.S.C. § 24 Seventh (emphasis added).

The Comptroller's implementing regulation defines investment security as "a marketable obligation in the form of a bond, note, or debenture *which is commonly regarded as an investment security*" that is not "predominantly speculative in nature." 12 C.F.R. § 1.3(b). (emphasis added).

The statutory language and the implementing regulation are clear: not all non-speculative, marketable debt obligations are "investment securities"; only those obligations that are *commonly known* or *regarded* as such qualify.[7] Consequently, the statute directs that the question of whether commercial paper constitutes an investment security be resolved only by resort to the common understanding of the nature of commercial paper by Congress, the regulatory agencies, and the banking industry.

The "investment securities" provision in section 16 did not originate in the Glass-Steagall Act, but in the prior provisions of the McFadden Act of 1927.[8] One of the purposes of the McFadden Act was to clarify the authority of national banks to deal in securities. At the beginning of this century, State chartered banks and trust companies, pursuant to liberal State legislation, became involved in a wide variety of investment banking functions, including the underwriting of debt and equity securities. National banks responded by expanding their activities to include the purchasing and selling—and underwriting and dealing in—not only municipal bonds but corporate bonds and stocks as well. *See* U.S. Department of the Treasury, Public Policy Aspects of Bank Securities Activities, App. 3-5 (1975). While the Comptroller permitted national banks to deal

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7 The contentions of the SIA and A.G. Becker that commercial paper is an investment security *merely* because such paper consists of marketable debt obligations ignore this plain language of the statute and the implementing regulation.

8 Pub. L. No. 639, ch. 191, 44 Stat. 1224.

in corporate debt,[9] there was no clear statutory authority for such activities. *Id.* In 1924, the Comptroller recommended legislation expressly to authorize national bank purchase and sale of investment securities.[10] The McFadden legislation followed in 1927.

Section 2 of that Act provided that the "business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse" marketable debt obligations commonly known as investment securities.[11] 44 Stat. 1226. This language was intentionally framed as a reaffirmance of the existing authority of national banks with respect to investment securities rather than as an affirmative grant of new power. *See* H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). The legislative history, however, is clear that the authority codified or confirmed by the McFadden legislation with respect to investment securities did not apply to commercial paper. This is made plain by the remarks of Congressman McFadden, the sponsor of the legislation, during debate on the bill. Mr. McFadden indicated that commercial paper is not considered an investment security (and thus would not be subject to the restrictions of the Act) but is subject to the statutory limitations on loans to individual borrowers. 67 Cong. Rec. 3232 (1926).[12]

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9 The Comptroller, as well as the courts, strictly forbade, however, national bank involvement in underwriting and dealing in equity securities. *Id.*, at 2-3, 5.

10 Annual Report of the Comptroller of the Currency for 1924, at 12.

11 This power was, of course, later restricted somewhat by the Glass-Steagall legislation.

12 The relevant colloquy involving Congressman McFadden is as follows:

> Mr. WAINRIGHT. Let me ask the gentleman whether *commercial paper, as generally understood and accepted*, is regarded as *investment security.*
>
> Mr. McFADDEN. *No; it is not.* Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities. *Id.* (emphasis added).

The view of the framers of the McFadden Act that commercial paper should be treated as a loan rather than as a security is consistent with historical studies of the commercial paper market that indicate that banks purchased and sold commercial paper (and served as commercial paper dealers) pursuant to their lending functions long before commercial banks began expanding their activities into the underwriting of corporate bonds and other debt obligations after the Civil War, activities that were restricted by the McFadden legislation concerning investment securities and, six years later, by the Glass-Steagall Act. Thus, the commercial paper activities of commercial banks were viewed as an independent operation separate from the banking industry's subsequent involvement with investment securities.[13]

Furthermore, it has been the consistent and uniform practice of the bank regulatory agencies for almost 50 years to consider commercial paper as a loan, not as an investment security. For example, the Board took the view in 1933, in letters to the House Commerce Committee and the Senate Banking Committee commenting on the proposed securities legislation of

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13 *See generally* A. Greef, The Commercial Paper House in the United States (1938) [hereinafter cited as "Greef"]; N. Baxter, The Commercial-Paper Market (1964); M. Myers, The New York Money Market, Vol. I (1932). Greef found, for example, that before 1840 commercial banks in various parts of the country were purchasing and selling commercial paper and that dealings by banks in commercial paper could be traced back to the first commercial banks organized in the United States. Greef, *supra*, at 6-7, 15-18. Indeed, by 1900 commercial banks and savings banks purchased 95 per cent of the commercial paper sold, *id.*, at 96, and commercial paper was recognized as an important form of secondary reserves for the banking system. B. Beckhart, The New York Money Market, Vol. III 236-242 (1932). In addition to purchasing commercial paper as an investment, banks participated in the selling of such paper as dealers. Greef, *supra*, at 63, 403-405; R. Foulke, The Commercial Paper Market 108 (1931). In light of the longstanding and intimate relationship of banks with commercial paper, the views of the framer of the investment security legislation that commercial paper was not subject to its provisions are consistent with common banking practice at the time.

1933, that commercial paper, "short-time paper issued for . . . obtaining funds for current transactions" and purchased by banks and corporations with temporarily idle funds should not be considered an investment security. The Board stated that the proposed legislation was apparently intended to apply only to "investment securities, which are issued for . . . obtaining capital funds . . . and are purchased by persons for investment."[14]

Although the Comptroller of the Currency is delegated primary responsibility for fashioning a definition of the term, the Comptroller has never formally ruled on the status of commercial paper as an investment security for purposes of section 16. However, in a letter to a national bank in 1971, the Comptroller's Chief Counsel took the position that commercial paper represents a loan (subject to the statutory limits on loans) and does not constitute an investment security.[15]

The present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan, not as an investment security. The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan. In addition, the Federal Reserve's manual of examination procedures follows the same position. In sum, based on the views of the framers of the investment securities provisions of section 16, of the banking industry, and of the regulators, the Board believes that commercial paper has not been, and is

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14 The Board's letters are reprinted in the hearings on the securities legislation. *Federal Securities Act: Hearing on H.R. 4313 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-181 (1933); *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933).

15 Under an interpretation issued by the Comptroller, the statutory limits on loans to individual borrowers (12 U.S.C. § 84) are separate and distinct from the limit prescribed by section 16 of the Glass-Steagall Act on holding investment securities of a single issuer. 12 C.F.R. § 7.1180.

not, "commonly known" as an "investment security" and thus does not meet the statutory criteria for investment securities under section 16.

"*Securities*" *other than* "*investment securities.*" Apart from the restrictions applicable to investment securities, sections 16 and 21 impose prohibitions with respect to securities in general. Section 16 generally prohibits dealing in "securities and stock." Section 21 states that depository institutions may not engage in the business of issuing or selling "stock, bonds, debentures, *notes* or other securities." (emphasis added). Since commercial paper conventionally consists of unsecured promissory notes, it may be argued that the term "notes" as used in section 21 is, under its usual meaning, broad enough to cover commercial paper. While the words in statutes should generally be interpreted in light of their ordinary meaning,[16] it is clear for a number of reasons that the term "notes" as used in section 21 should not be interpreted according to its literal sense. First, by its terms section 21 describes depository institutions (institutions that section 21 prohibits from issuing and selling "notes") as engaged in the business of receiving deposits evidenced by a "certificate of deposit or other evidence of debt"—instruments that themselves may be classified as "notes." Thus section 21 itself expressly permits banks to issue and sell certain kinds of notes—notes evidencing deposits. Second, the Glass-Steagall Act was plainly designed to keep banks from engaging in the investment banking business, not to prohibit banks from performing the traditional functions of banks.[17] Ordinary lending transactions are evidenced by notes

16 *See, e.g.*, *Perrin* v. *United States*, 444 U.S. 37, 42 (1979).

17 *See Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971) [hereinafter cited as "*ICI* v. *Camp*"]. Indeed the Supreme Court in the *Camp* case noted that commercial banks traditionally ". . . lend money, discount and negotiate promissory *notes* . . ." *Id.* (emphasis added). Indeed, if commercial paper were deemed to be a security other than an investment security, banks would be prohibited even from purchases of commercial paper for their own account, an activity that banks have long engaged in and continue to conduct. *See* Greef, *supra* note 13, at 96; Hurley, *supra* note 1, at 529.

and, in addition, banks commonly sell such notes to other lenders. It is evident that to view a note representing a bank loan as a security for Glass-Steagall Act purposes and, thus, the sale of such notes as an investment banking activity forbidden by the Act is completely at odds with the basic purpose of the Act. The rules of statutory interpretation do not require a literal reading of the term "notes" that would thwart the clear purpose of the Act and that leads to irrational results.[18]

Since the plain meaning of the statute cannot be dispositive of whether commercial paper is a security under the Glass-Steagall Act, it is appropriate to examine the history of the Act to attempt to resolve the question. It appears that Congress never adverted to bank involvement with commercial paper when it considered the Glass-Steagall legislation. There is, however, some indirect evidence that Congress did not view commercial paper, at least as the commercial paper market then existed, as the kind of obligation that would be subject to the Act. It is commonly agreed that the Glass-Steagall Act resulted from a number of specific abusive practices with respect to securities that had grown up in the banking industry. In particular, Congress was concerned about the risks and dangers to the banking system resulting from bank involvement with the "speculative operations" in securities characteristic of investment banking and with the practice of banks, begun in 1908, of establishing "security affiliates" that engaged, among other things, in underwriting bond and stock

18 *See, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643 (1978). This approach has been taken by the courts in interpreting the definition of security in the securities acts, which generally define "security" to include "any note." The courts have not applied this language literally to bring all notes within the ambit of the securities laws but, on a variety of theories, have for the most part concluded that notes evidencing traditional lending transactions are not covered. *Exchange National Bank of Chicago v. Touche, Ross & Co.*, 544 F.2d 1126, 1131-1138 (2d Cir. 1976). *See generally United Housing Foundations, Inc. v. Forman*, 421 U.S. 837, 848-850 (1975).

issues. *ICI* v. *Camp*, *supra* note 17, 401 U.S. at 629-630, 632.[19] The Glass-Steagall bill was enacted only after extensive hearings on its provisions had been held in 1931 and 1932. Neither the Board nor the parties have been able to find any evidence of congressional concern about bank involvement with commercial paper. Morevoer, because at the time that the Glass-Steagall Act was being considered commercial banks purchased for their own account almost all of the commercial paper issued and commercial paper served as an important source of secondary reserves,[20] it may well be doubted that Congress could have been unaware of the extensive relationship then existing between the banking system and the commercial paper market.

Moreover, while there is no direct evidence in the legislative history of the Glass-Steagall Act on the status of commercial paper under the Act, there is evidence of contemporaneous statements by one of the draftsmen of the Act that commercial paper should not be considered a security. While the Glass-Steagall Act was pending before Congress in 1933, Congress was also considering the legislation that became the Securities Act of 1933. During Senate consideration of the securities bill, Senator Glass, the chief architect of the prohibitions against bank securities activities, proposed that short-term notes, including "9 months' commercial paper," be excluded from the definition of securities contained in that bill because to define such obligations as securities would "radically interfere" with "ordinary commercial banking transactions."[21] While Senator

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19 *See also Russell* v. *Continental Illinois National Bank & Trust Co.*, 479 F.2d 131 (7th Cir.), *cert. denied*, 414 U.S. 1040 (1973); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968); *New York Stock Exchange, Inc.* v. *Smith*, 404 F. Supp. 1091 (D.D.C. 1975), *rev'd on other grounds*, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978).

20 *See* note 13 *supra*.

21 *Securities Act: Hearings on S. 875 before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933).

Glass's proposed amendment was eventually adopted only as an exemption from some of the substantive provisions of the Securities Act,[22] his statements concerning the need for such an amendment strongly suggest that one of the principal draftsmen of the Glass-Steagall Act viewed commercial paper as closely linked to "ordinary commercial banking transactions" and not as involving the speculative investment banking functions that the legislation he sponsored was intended to restrain.[23]

In the course of administering the Glass-Steagall Act over the years the Board has not applied the Glass-Steagall Act prohibitions to the activities of banking organizations with respect to commercial paper. As noted above in the discussion of investment securities, the Board has traditionally viewed commercial paper purchased for a bank's own account as a loan, not as a security, for purposes of call reports. Furthermore, in its 1973 interpretation of the Glass-Steagall Act with respect to the sale of thrift notes (small denomination unsecured notes sold more or less continuously) by bank holding companies, the Board, while not expressly finding that commercial paper is not a security, stated that the issuance of commercial paper by a bank holding company "is not an activity intended to be included within the scope of section 20 of the Glass-Steagall Act." 12 C.F.R. § 250.221.

In addition to a review of the legislative history and agency interpretation, it is also appropriate to consider the status of commercial paper under the Act in light of the purposes for

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22 The effect of this action by Congress is discussed below.

23 The SEC argues that the testimony of Senator Glass is not persuasive because the Securities Act was enacted *before* the Glass-Steagall Act. Thus, according to the SEC, Senator Glass, if he really believed commercial paper was not a security, would have attempted, after a broad definition of "security" was adopted in the Securities Act, to amend the Glass-Steagall Act to exclude commercial paper. However, this argument assumes, without any support, that Senator Glass viewed the Securities Act definitions as germane to the Glass-Steagall Act.

which the Act was passed—to separate commercial and investment banking. As noted above with respect to the definition of "notes", a broad generic or literal reading of the term "security" would likely encompass a number of instruments that banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress. However, it would seem that if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.

If such an approach is taken with respect to commercial paper, the Board believes that the stronger conclusion is that commercial paper currently being sold by Bankers Trust represents a financing transaction that is closer in function to commercial lending than to the sale of an investment. Historically, the dividing line between commercial and investment banking depended on whether short-term or long-term funds were being provided. As a short-term instrument, commercial paper fell on the commercial banking side of the line. Historical studies of the commercial paper market indicate that, as that market originated and developed, commercial paper was the functional equivalent of a bank loan. Commercial paper was used to raise funds for short-term needs and was sold almost exclusively to commercial banks.

It is clear, however, that the commercial paper market has changed somewhat in recent years. Most notably, commercial banks are no longer the predominant purchasers of commercial paper.[24] Nevertheless, the Board is of the opinion that, after a review of Bankers Trust's activities, the commercial paper currently being sold by the bank appears to evidence transactions that are more like commercial lending transactions than the sale of investments. First, the commercial paper sold

24 *E.g.*, Hurley, *supra* note 1, at 529.

by Bankers Trust, like commercial paper generally, is a short-term instrument. While it may no longer be said that the provision of short-term credit to business is exclusively the function of banks, short-term loans continue to be the principal activity of commercial banks.[25] In addition, a typical commercial loan transaction involves a borrower and a single lender or, in the case of a loan participation, a relatively small number of lenders, that regularly extend credit as part of a business. Likewise, the purchasers of the commercial paper sold by Bankers Trust are relatively few in number and purchase paper in denominations larger than an average investor might be expected to afford. Moreover, it appears that most of the purchasers of the paper are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis. These facts, in the Board's view, support the conclusion that the commercial paper currently being sold by Bankers Trust is more analogous to a commercial loan than to an investment. This view is consistent with the legislative history of the Glass-Steagall Act and the Board's general approach to commercial bank involvement with commercial paper. Accordingly, the Board believes that the stronger argument is that commercial paper should not be considered a security for the purposes of the Glass-Steagall Act.[26]

The Securities Act of 1933. The SIA, A.G. Becker, and the SEC argue that because commercial paper is a security for purposes of the Securities Act of 1933,[27] commercial paper

25 While it is the practice of commercial paper issuers to reissue (roll over) paper at maturity, the purchasers of the paper, unlike the holders of bonds or other longer term instruments, have the legal right to demand payment at the original maturity date.

26 The Board's conclusion is limited to the obligations generally recognized as commercial paper: prime quality, negotiable, usually unsecured, promissory notes with maturities less than nine months that are exempt from the registration requirements of the Securities Act of 1933. The Board expresses no opinion with regard to the sale by a bank of third party obligations that do not meet these criteria.

27 Act of May 27, 1933, ch. 38, 48 Stat. 74.

must likewise be viewed as a "security" under the Glass-Steagall Act. Under section 2(1) of the Securities Act, 15 U.S.C. § 77b(1), the term "security" includes "any note." Section 3(a)(3) of that Act exempts from the registration and prospectus-delivery requirements of the Act any note the proceeds of which are used for current transactions and with a maturity of nine months or less. 15 U.S.C. § 77c(a)(3). Under sections 12(2) and 17(c), 15 U.S.C. §§ 77l(2), 77q(c), such short-term notes are not exempt from the antifraud prohibitions of that Act. Consequently, it is generally held that commercial paper is a security (albeit an exempt security) for purposes of the Securities Act.[28] The petitioners and the SEC contend that the Securities Act definition of "security" should be read into the Glass-Steagall Act because the two pieces of legislation address the same activities and were enacted within three weeks of each other in 1933.[29]

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28 *Franklin Savings Bank* v. *Levy*, 551 F.2d 521, 524 n.6 (2d Cir. 1977). With respect to the status of commercial paper under the other major federal securities law, the Securities Exchange Act, the question is not as clear. Unlike the 1933 Act, the 1934 Act expressly exempts commercial paper from that Act's *definition* of security. 15 U.S.C. § 78c(a)(10). The courts have not applied the exclusion literally, and courts have found that commercial paper is covered under the 1934 Act, at least where the particular commercial paper involved did not meet the criteria for exemption from registration under the 1933 Act, *e.g.*, the commercial paper was sold to the public. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1078-1080 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972).

29 Petitioners and the SEC rely on the legal analysis contained in a 1977 Board staff study of commercial bank private placements, which concluded that the definitions of "issue", "underwriter", and "distribution" in the Securities Act were "a compelling analogy" to the same terms employed in the Glass-Steagall Act. The Board has never formally reviewed the legal conclusions of the staff's private placement study. However, the private placement legal analysis does not necessarily contradict the position taken here. The private placement conclusions do not suggest that the definitions of the Securities Act are *conclusive*. In addition, the Board believes there is a distinction between definitions of activities carried on in the securities business and the definitions of a security, which are jurisdictional in nature and more closely linked to the purposes for which each Act was enacted.

Statement Regarding Petitions to Initiate Enforcement Action

While it seems clear that the definition of security in the Securities Act is relevant to a determination with regard to what instruments Congress thought were securities covered by the Glass-Steagall Act, it is the Board's opinion that the definition of security in the federal securities laws cannot be deemed conclusive for Glass-Steagall Act purposes. In the Board's view, this conclusion is supported by a number of arguments, but the most persuasive argument is that the definition of security under the Securities Act encompasses a variety of instruments that represent traditional banking functions and that to apply the prohibitions of the Glass-Steagall Act to such obligations would make illegal functions that clearly are properly part of the business of banking.[30] For example, a bankers' acceptance, like commercial paper, is a security under the Securities Act but exempt from registration. 15 U.S.C. §§ 77b(1), 77c(a)(3). However, commercial banks routinely purchase and sell bankers' acceptances and commercial banks (including Bankers Trust) serve as dealers in bankers' acceptances. Indeed, the Board determined as long ago as 1934 that bankers' acceptances were *not* securities under the Glass-Steagall Act.[31] To view the Securities Act definition of security as conclusive for Glass-Steagall purposes, as the securities industry representatives and the SEC suggest, would require that the traditional activities of commercial banks regarding bankers' acceptances be considered as the prohibited dealing in securities. This result is clearly contrary to the intent of the Glass-Steagall Act, which was not intended to restrict commercial banking functions. *ICI* v. *Camp*, *supra* note 17, at 629. In addition, although the courts are not unanimous, the

30 It should also be noted that the Securities Act and the Glass-Steagall Act were not enacted to accomplish the same objectives. The Securities Act is an *investor* protection measure; the Glass-Steagall act is designed to protect *banks*, not investors. *Russell* v. *Continental Illinois National Bank & Trust Co.*, *supra*, note 19.

31 Letter, dated June 8, 1934, from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of New York.

securities laws have in some cases been held applicable to certificates of deposits issued by banks,[32] passbook savings accounts,[33] loan participations,[34] and bills of exchange.[35] Under the theory advanced by the SIA, A.G. Becker, and the SEC, banks would be prohibited from issuing,[36] selling, or dealing in each of these instruments on the grounds that doing so is the prohibited business of investment banking. The Board does not believe such contentions are consistent with the purpose of the Act.[37]

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32 *Garner v. Pearson*, 374 F. Supp. 591, 596 (M.D. Fla. 1974).

33 *SEC v. First American Bank & Trust Co.*, 481 F.2d 673, 678 (8th Cir. 1973).

34 *Lehigh Valley Trust Co. v. Central National Bank of Jacksonville*, 409 F.2d 989, 991-992 (5th Cir. 1969).

35 *MacAndrew & Forbes Co. v. American Barmag Corp.*, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,532 (D.S.C. 1972).

36 The SEC states that considering time deposits as securities under the Glass-Steagall Act would not disrupt the statutory scheme of that Act because the Act does not prohibit a bank from issuing its *own* securities—only dealing in or underwriting the securities issued by *others*. However, section 21 plainly prohibits banks from engaging in the business of "issuing" and "selling" securities and does not limit such securities to those of third parties. While Board staff has taken the position that a bank's occasional issuance of its own stock, bonds, or debentures (an activity essential to the viability of the organization) does not constitute being engaged "in the business" of issuing securities under section 21, it seems clear that banks issue and sell time deposits, bankers' acceptances, and similar instruments as a regular part of their "business" and, if such instruments are considered securities for Glass-Steagall Act purposes, banks would be prohibited by the Act from such activities.

37 The Board expresses no opinion regarding the legal status of the commercial paper sold by Bankers Trust under the Securities Act of 1933 or under any other law except the Glass-Steagall Act. It is noted, however, that commercial paper has been held to be a security for at least some purposes under the federal securities laws. *See* pages 136A-137A, *supra*.

Statement Regarding Petitions to Initiate Enforcement Action

Because of the historical involvement of the banking industry with commercial paper, the nature of the commercial paper currently sold by Bankers Trust, and the fact that commercial paper is exempt from the substantive obligations of the Securities Act of 1933 (except for the antifraud provisions), the Board concludes that, notwithstanding the status of commercial paper as an exempt security under the Securities Act, the stronger argument is that commercial paper is not a security for purposes of the Glass-Steagall Act.

B. *Bankers Trust's Activities as Dealing in or Underwriting Securities*

Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

C. *Policy Concerns Behind the Glass-Steagall Act*

The SIA, A.G. Becker, and the SEC also assert that the selling of commercial paper by Bankers Trust produces the same kinds of risks to the bank and potential for conflicts of interest that Congress intended to eliminate in enacting the Glass-Steagall Act. In its opinion on the Glass-Steagall Act in *ICI* v. *Camp*, *supra* note 17, the Supreme Court analyzed the scope of the Act in terms of specific "hazards" and "financial dangers" that Congress had in mind when banks engaged in activities prescribed by the Act. 401 U.S. at 630.

At the outset, the Board notes that since the stronger view is that commercial paper should not be considered a security for Glass-Steagall Act purposes, the sale of commercial paper by Bankers Trust is not prohibited by the specific terms of that Act. Accordingly, it does not appear necessary to examine the dangers that the Act was intended to eliminate.[38] Nevertheless,

38 *See Aaron* v. *SEC*, 100 S. Ct. 1945, 1955 (1980).

the Board believes that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking.[39] Thus, the Board, in cooperation with the other federal bank regulatory agencies, has initiated the process of developing guidelines governing the sale of third party commercial paper by a commercial bank designed to prevent potential unsafe or unsound practices that could arise in such an activity. When these guidelines are developed and submitted to the Board for consideration, the Board will address in that proceeding the general issues raised by the allegations of petitioners and the SEC relating to potential undue risks to banks or conflicts of interest arising from this activity.

Public Policy Considerations

A.G. Becker advances a number of public policy considerations that it claims militate against permitting a commercial bank to sell third party commercial paper. A.G. Becker first asserts that a full-service commercial bank selling commercial paper enjoys unfair competitive advantages over nonbank sellers because banks would be able to offer a package of services to an issuer of commercial paper that the nonbank seller could not offer. A.G. Becker also cites the potential for predatory pricing, access as settlement agent to the customer lists of competing sellers, and the cut-off of credit to nonbank sellers of commercial paper.[40] The Board's review of Bankers Trust's current operations in selling commercial paper has not uncovered any evidence at this time of such alleged unfair competitive practices.

It is next claimed that persons classified as "brokers" under the Securities Exchange Act of 1934 are subject to a number of

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39 *See* 12 U.S.C. § 1818(b).

40 A.G. Becker claims that the asserted advantages constitute "unfair practices" by banks under section 18(f) of the Federal Trade Commission Act and the Board's Regulation AA. 12 C.F.R. § 227.

regulatory requirements designed to protect investors and that banks (which are exempt from the definition of broker in the Securities Exchange Act) are not subject to similar restrictions. However, since commercial paper is exempted from the definition of security in the Securities Exchange Act,[41] it would appear that a nonbank seller of commercial paper is not subject to the provisions of that Act if commercial paper is the only instrument sold. In any event, commercial banks are subject to certain investor protection requirements in connection with their securities transaction activities similar to those imposed on nonbank brokers. *E.g.*, C.F.R. § 208.8(k). Moreover, Bankers Trust sells commercial paper only to sophisticated institutional investors that would appear to be less in need of many of the safeguards designed to protect average investors.

Finally, A.G. Becker claims that if commercial banks become dominant in the commercial paper market, the resulting competition may reduce the efficiency of the securities industry and impair the capital-raising mechanism provided by that industry. Presently, however, Bankers Trust is by no means dominant in the commercial paper market and there is no available evidence of disruption of the capital markets as a result of Bankers Trust's activities. Accordingly, the Board believes that the policy considerations advanced by A.G. Becker do not at this time warrant prohibition of Bankers Trust's selling of third party commercial paper.

In summary, the Board has determined to deny the petitions of the SIA and A.G. Becker to the extent such petitions allege that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy. The Board is taking no action regarding petitioners' contentions of dangers to Bankers Trust and potential conflicts of interest and will consider these issues in the context of the Board's consideration of guidelines governing the sale of third party commercial paper by commercial banks.

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41 15 U.S.C. § 78c(a)(10).

Statement Regarding Petitions to Initiate Enforcement Action

Request for Oral Argument

Counsel for A.G. Becker has requested the opportunity to present oral argument to the Board when this matter is submitted to the Board for consideration. However, the Board as yet has initiated no agency proceedings in connection with Bankers Trust's commercial paper activities and A.G. Becker is not a party to any agency proceeding pending before the Board. The Board notes that counsel for A.G. Becker has met with the Board's staff on at least two occasions concerning the activities of Bankers Trust. Moreover, the Glass-Steagall Act issues resolved by the Board are essentially legal in nature and all the interested organizations have submitted extensive written arguments on these issues. In the Board's view, these written submissions adequately explain the issues involved and oral argument before the Board at this time would serve no useful purpose. Accordingly, the request by A.G. Becker for oral argument before the Board on this matter is denied.

Letter, dated October 16, 1980, from Theodore E. Allison to Harvey L. Pitt

OCT 16 1980

Harvey L. Pitt, Esq.
Fried, Frank, Harris, Shriver
& Kampelman
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037

Dear Mr. Pitt:

This is in response to the "Application for Stay" submitted by A.G. Becker Incorporated ("A.G. Becker") dated October 2, 1980, with respect to the Board's letter and statement, dated September 26, 1980, regarding the petition of A.G. Becker that the Board prohibit Bankers Trust Company ("Bankers Trust") from selling commercial paper of issuers not related to the bank ("third party commercial paper"). The Board's letter and statement denied A.G. Becker's petition and the similar petition of the Securities Industry Association (the "SIA") to the extent the petitions allege that Bankers Trust's activities violate the Glass-Steagall Act or that such activities should be prohibited by general considerations of public policy. However, noting that the sale of third party commercial paper by a bank could involve, at least in some circumstances, unsafe or unsound banking practices, the Board took no action on petitioners' contentions of dangers to Bankers Trust and potential conflicts of interest arising from such activities, pending the Board's consideration of these issues in the context of its consideration of general guidelines, developed in cooperation with the other bank regulatory agencies, designed to prevent unsafe or unsound practices in the sale of commercial paper by a bank.

A.G. Becker requests that the Board immediately issue an order prohibiting Bankers Trust "and all of the member banks" from selling commercial paper until either a court resolves the propriety of the Board's action or the Board implements guidelines to prevent unsafe or unsound practices.

Letter, dated October 16, 1980

A.G. Becker states that this action is necessary because such guidelines may not be implemented until after the nation's commercial banking system has been exposed to substantial injury as a result of unsafe or unsound practices in the sale of commercial paper.

The Board does not interpret A.G. Becker's petition as an application for a stay, in the usual sense, of an agency action, since the Board's action of September 26, 1980, with respect to Bankers Trust's commercial paper activities constitutes no authorization for any activities and imposes no requirements or disabilities on any person. The Board's action did not authorize Bankers Trust (or any other bank) to engage in any activities. Bankers Trust is organized under the laws of the State of New York and the scope of its authority to engage in the banking business is determined in the first instance by those laws. In its action of September 26, the Board merely determined that the Board would not at this time initiate enforcement proceedings against Bankers Trust to prevent the challenged activities on the basis of some (but not all) of the grounds advanced in the petitions of A.G. Becker and the SIA. The postponement or stay of the effectiveness of such a decision not to take action would not appear to have any practical meaning in terms of the rights of the interested organizations.

A.G. Becker appears, rather, to be requesting special interim relief prohibiting all commercial paper activities by member banks pending implementation of the proposed guidelines or judicial review, based on the Board's finding that the sale of commercial paper may involve at least in some circumstances unsafe or unsound banking practices. In the Board's view, such relief is not within the Board's authority and is not warranted. With respect to preventing unsafe or unsound banking practices, the Board's authority under the Financial Institutions Supervisory Act is limited to State-chartered member banks. The Board has no cease-and-desist authority over national banks. 12 U.S.C. §§ 1813(q), 1818(b)(1).

Letter, dated October 16, 1980

While the Board is concerned about possible unsafe or unsound practices that could be involved in Bankers Trust's commercial paper activities and in similar activities by any other State member bank that commences such activities prior to implementation of the guidelines, the Board does not believe that any possible unsafe or unsound practice that might be involved in Bankers Trust's present selling activities poses an immediate threat to the safety of the bank or to its depositors. This finding is based on the Board's review of all of Bankers Trust's practices in selling commercial paper during the Board's consideration of the petitions of A.G. Becker and the SIA and on the fact that any undue risks that might be involved in the bank's commercial paper operations are not substantial in relation to the bank's total resources. Moreover, the activities of State member banks other than Bankers Trust were not challenged by A.G. Becker and it does not appear that other State member banks plan imminently to initiate selling third party commercial paper on a significant scale. Finally, the procedure for developing guidelines for the sale of third party commercial paper has already been initiated and the Board expects to consider such guidelines without undue delay.

For the above reasons, the Board has determined to deny A.G. Becker's request for an immediate Board order prohibiting Bankers Trust and all other member banks from selling third party commercial paper pending judicial review of the Board's action on A.G. Becker's petition or pending implementation of guidelines to prevent unsafe or unsound practices.

Very truly yours,

(signed) THEODORE E. ALLISON
Theodore E. Allison
Secretary of the Board

RMA:gjr
10/16/80

SIA Complaint for Declaratory Judgment, Injunctive and Other Relief, in Civil Action No. 80-2730 (D.D.C., filed October 24, 1980)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION, 20 Broad Street, New York, N.Y., (212) 425-2700,

Plaintiff,

—v.—

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, Federal Reserve Building, Constitution Avenue, N.W., Washington, D.C. 20551,

—and—

PAUL A. VOLCKER, as Chairman of the Board of Governors of the Federal Reserve System, Federal Reserve Building, Constitution Avenue, N.W., Washington, D.C. 20551,

—and—

FREDERICK H. SCHULTZ, NANCY H. TEETERS, J. CHARLES PARTEE, HENRY C. WALLICH, EMMET J. RICE, LYLE E. GRAMLEY, as Members of the Board of Governors of the Federal Reserve System, Federal Reserve Building, Constitution Avenue, N.W., Washington, D.C. 20551,

Defendants.

COMPLAINT FOR DECLARATORY JUDGMENT AND INJUNCTIVE AND OTHER RELIEF

Plaintiff, by its attorneys, brings this action against the above-named defendants and alleges:

Jurisdiction and Venue

1. This is a civil action for declaratory judgment and injunctive and other relief. It arises under various sections of the Banking Act of 1933, as amended (herein referred to as the "Glass-Steagall Act"), codified in various sections of Title 12 of the United States Code, and the regulations thereunder; the Federal Reserve Act of 1913, 12 U.S.C. §§ 221 *et seq.*, and the regulations thereunder; the Federal Deposit Insurance Corporation Act, as amended, 12 U.S.C. §§ 1811, *et seq.*, and the regulations thereunder; the Declaratory Judgment Act, 28 U.S.C. §§ 2201 and 2202; and the Administrative Procedure Act, 5 U.S.C. §§ 701 *et seq.*. Jurisdiction is conferred on this Court by 28 U.S.C. §§ 1331. Venue lies in this district pursuant to 28 U.S.C. § 1391. There exists between the plaintiff and the defendants an actual controversy, justiciable in character, in respect of which plaintiff requires a determination of its rights by this Court. The amount in controversy exceeds ten thousand dollars ($10,000).

2. Because of uncertainty concerning the appropriate forum for review of the Board's action, and in order to preserve its rights, plaintiff is filing a Petition for Review of the Board's action in the United States Court of Appeals for the District of Columbia Circuit simultaneously with this Complaint.

Parties

3. Plaintiff Securities Industry Association (herein referred to as the "SIA") is an association incorporated in the State of Delaware and having its principal place of business in the City of New York in the State of New York and having an office in Washington, D.C. The SIA is a national trace association representing approximately 500 organizations responsible for over 90 percent of the securities brokerage and investment banking business of the nation, for which it sues in a representative capacity. Its membership is a cross section of the securities industry: the business of its members includes, *inter alia*,

retail and institutional brokerage, over-the-counter market making, underwriting and other investment banking activities and the distribution and trading of commercial paper and other securities. The firms which comprise the SIA's membership are located across the nation and provide services to investors of every size and type.

4. Defendant Board of Governors of the Federal Reserve System (herein referred to as the "Federal Reserve Board" or the "Board") is an agency of the United States Government, created by the Federal Reserve Act of 1913, 12 U.S.C. §§ 221 *et seq.*, and charged with the responsibility of administering, enforcing and regulating the nation's banking system in accordance with, *inter alia*, various provisions of Title 12 of the United States Code, including various provisions of the Glass-Steagall Act and the Federal Deposit Insurance Corporation Act. The Board is an "agency" within the meaning of the Administrative Procedure Act, 5 U.S.C. § 551(2). Defendant Volcker is Chairman of the Board; defendants Schultz, Teeters, Partee, Wallich, Rice, and Gramley are individual members of the Board, and are named as defendants herein in such capacities.

Statutory Framework

5. The Glass-Steagall Act was enacted in 1933 in response to the collapse of the commercial banking system during the Great Depression. Congress perceived that crisis to have been caused in large part by the abuses stemming from bank involvement in the securities business, and the Glass-Steagall Act was designed to remedy these abuses by divorcing commercial banking from investment banking.

6. Section 16 of the Glass-Steagall Act, 12 U.S.C. § 24 Seventh, limits the business of dealing in securities and stock by any national bank "to purchasing and selling such securities and stock without recourse, solely upon the order, and for the

account of, customers, and in no event for its own account. . . ." Such banks are also expressly prohibited from "underwrit[ing] any issue of securities or stock". The provisions of Section 16 are made applicable to state member banks by Section 5(c) Fifth of the Glass-Steagall Act, 12 U.S.C. § 335.

7. Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378, makes it unlawful for any person or financial institution "engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes or other securities, to engage at the same time to any extent whatever in the business of receiving deposits" except to the extent permitted to national banking associations by Section 16 of the Glass-Steagall Act.

8. Section 8 of the Federal Deposit Insurance Corporation Act, 12 U.S.C. § 1818, empowers the Federal Reserve Board to institute cease-and-desist proceedings against any "insured bank" which has violated or is about to violate any federal laws, rules or regulations or which has engaged or is about to engage in unsafe or unsound banking practices.

The Board's Action

9. On information and belief, on or before July 26, 1978, Bankers Trust Company ("Bankers Trust"), a state member bank of the Federal Reserve System and an "insured bank" within the meaning of the Federal Deposit Insurance Corporation Act, 12 U.S.C. §§ 1811 *et seq.*, began a new program of underwriting, selling and dealing in commercial paper and distributing such securities to the public. On information and belief, Bankers Trust since that time has engaged in such underwriting, selling, and dealing in commercial paper and has purchased in the secondary market commercial paper of issuers for which it has acted as underwriter, seller and dealer. In doing so Bankers Trust has placed itself in competition with the members of the SIA active in the commercial paper business.

10. During November 1978 the SIA became aware that the Federal Reserve Board was engaged in a study of the distribution of commercial paper by Bankers Trust. As a member bank, Bankers Trust is subject to the regulatory supervision of the Board, and as an insured bank, it is subject to cease-and-desist proceedings which may be instituted by the Federal Reserve Board in respect of its operations.

11. On January 31, 1979, the SIA submitted to the Board's General Counsel a memorandum discussing the propriety and permissibility of commercial paper distribution activities by member banks and pointing out that, as a matter of law, the commercial paper activities of Bankers Trust violate the Glass-Steagall Act. On June 28, 1979 the General Counsel of the Board issued an opinion in which he concluded that, with certain limited exceptions, the sale of commercial paper by a commercial bank such as Bankers Trust was not prohibited by the Glass-Steagall Act. On July 26, 1979 the SIA filed an Application for Review with the Board which supplemented its memorandum of January 31, 1979 and requested the Board, among other things, formally to review the commercial paper activities of Bankers Trust and to order Bankers Trust to cease and desist from all its third party commercial paper activities.

12. On September 26, 1980 the Board denied the petition filed by the SIA. The Board stated that the issues involved were "primarily legal" in nature and based its action on its stated legal determination that "the financing instrument commonly known as commercial paper is not a 'security' within the meaning of the Glass-Steagall Act."

13. The Board's action constituted a final disposition of the proceedings instituted by the SIA concerning the commercial paper activities of Bankers Trust and constituted final agency action within the meaning of the Administrative Procedure Act.

14. On October 16, 1980, the SIA submitted to the Board an application in the form of a letter stating its intention to seek prompt review of the Board's decision in federal court and requesting that the Board immediately stay the effectiveness of its September 26, 1980 action until a court resolves the propriety of the Board's action and the activities of Bankers Trust. To date the Board has failed to grant this request.

Violation of the Federal Banking Laws

15. The activities engaged in by Bankers Trust constitute underwriting, selling and dealing in securities in violation of Sections 16 and 21 of the Glass-Steagall Act and as a matter of law constitute unsafe or unsound banking practices.

16. The Board's action of September 26, 1980 was arbitrary, capricious, an abuse of discretion, not in accordance with law, without any rational basis, and in excess of its statutory authority in that it was based solely on an erroneous legal conclusion and purports to sanction the illegal commercial paper activities of Bankers Trust and other similarly situated banks.

17. The illegal action of the Board, and the illegal activities on the part of Bankers Trust which it purports to sanction, will have an immediate and deleterious effect on the members of the SIA and on the public at large. The members of the SIA, for which it sues in a representative capacity, will suffer present and continuing serious and irreparable injury as a direct result of the unlawful activities authorized thereby. This illegal activity will subject the SIA's members to unlawful competition, will deprive them of legitimate business, and will dilute, divert and withdraw a substantial portion of the potential market for third party commercial paper to the substantial and irreparable injury of such members of the SIA. Moreover, the Board's action and the illegal activities of Bankers Trust will contribute to precisely those dangers against which the Glass-Steagall Act was originally directed.

18. The members of the SIA—which are all themselves subject to prohibitions of the Glass-Steagall Act preventing them from expanding their operations into the commercial banking business—are directly interested and aggrieved parties entitled to review and challenge this action of the Federal Reserve Board. The SIA has exhausted the administrative remedies available to it, has no adequate remedy at law and has no means available to it to protect the rights infringed by the Board's action other than the present action. Plaintiff SIA, and its members for which it sues in its representative capacity, will be permanently and irreparably harmed if the Court does not grant the relief prayed for herein.

WHEREFORE, plaintiff prays:

1. That this Court declare invalid the Board's determination and ruling that as a matter of law commercial paper is not a "security" within the meaning of the Glass-Steagall Act and that the Glass-Steagall Act does not prohibit member banks from underwriting, selling or dealing in commercial paper;

2. That this Court declare invalid the refusal of the Board to institute cease-and-desist proceedings and to issue a cease-and-desist order against Bankers Trust in connection with its commercial paper activities;

3. That this Court hold unlawful and set aside the action of the Board dated September 26, 1980;

4. That this Court enjoin defendants and their successors to set aside and withdraw the Board's action;

5. That this Court enjoin defendants and their successors immediately to institute cease-and-desist proceedings against Bankers Trust and any and all other member banks engaging in or about to engage in similar illegal commercial paper activities; and

6. That this Court grant such other and further relief as may be appropriate.

Respectfully submitted,

/s/ JOHN M. LIFTIN
John M. Liftin
James B. Weidner
Janet R. Zimmer
Thomas M. Shoesmith

Rogers & Wells
1666 K Street, N.W.
Washington, D.C. 20006
(202) 331-7760

Attorneys for the
Plaintiff Securities
Industry Association

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
20 Broad Street
New York, N.Y.

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

SIA Petition for Review in Civil Action No. 80-2314 (D.C. Cir., filed October 24, 1980)

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Civil Action No. 80-2314

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

—v.—

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

—and—

PAUL A. VOLCKER, as Chairman of the Board of Governors of the Federal Reserve System,

—and—

FREDERICK H. SCHULTZ, NANCY H. TEETERS, J. CHARLES PARTEE, HENRY C. WALLICH, EMMET J. RICE, LYLE E. GRAMLEY, as Members of the Board of Governors of the Federal Reserve System,
Respondents.

PETITION FOR REVIEW

The Securities Industry Association hereby petitions this Court to stay, enjoin, set aside, suspend, modify or otherwise review an order of the Board of Governors of the Federal Reserve System dated September 26, 1980, for such other and further relief as may be just, necessary and appropriate, and for any further relief as may be just, necessary and appropriate in aid of the jurisdiction of this Court.

Petition for Review

Because of uncertainty concerning the appropriate forum for review of the Board's action, petitioner is filing simultaneously with this Petition for Review a Complaint in the United States District Court for the District of Columbia naming as defendants the respondents herein.

The Securities Industry Association is a national trade association whose members are engaged in the securities brokerage and investment banking business.

The order of the Board is attached hereto as Exhibit A.

Respectfully submitted,

/s/ JOHN M. LIFTIN
John M. Liftin
James B. Weidner
Janet R. Zimmer
Thomas M. Shoesmith

Rogers & Wells
1666 K Street, N.W.
Washington, D.C. 20006
(202) 331-7760

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
20 Broad Street
New York, N.Y.
(212) 425-2700

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

Defendants' Motion to Dismiss or, in the Alternative, for Summary Judgment, filed in Civil Action No. 80-2730 (D.D.C.)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al., 20th and Constitution Avenue, N.W., Washington, D.C. 20551, Telephone: (202) 452-3000,

Defendants.

DEFENDANTS' MOTION TO DISMISS OR, IN THE ALTERNATIVE, FOR SUMMARY JUDGMENT

Pursuant to Rule 12(b)(1), Federal Rules of Civil Procedure, defendants, by their undersigned counsel, hereby move to dismiss this action on the grounds that the Court lacks jurisdiction over the subject matter of the action. In the alternative, defendants move for summary judgment pursuant to Rule 56(b), Federal Rules of Civil Procedure, on the ground that there are no genuine issues of material fact and defendants are entitled to judgment as a matter of law.

In support of their motion, defendants respectfully refer the Court to the attached Memorandum of Points and Authorities

in Support of Defendants' Motion to Dismiss or, in the Alternative, for Summary Judgment, and the Exhibit thereto.

Respectfully submitted,

NEAL L. PETERSEN
General Counsel

JAMES V. MATTINGLY, JR.
Assistant General Counsel

/s/ RICHARD M. ASHTON

RICHARD M. ASHTON
Attorney
Board of Governors of the
Federal Reserve System
20th and Constitution Avenue, N.W.
Washington, D.C. 20551
(202) 452-3750

Counsel for defendants.

DATED: January 19, 1981

Defendants' Statement of Material Facts As to Which There is No Genuine Issue filed in Civil Action No. 80-2730 (D.D.C.)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

DEFENDANTS' STATEMENT OF MATERIAL FACTS AS TO WHICH THERE IS NO GENUINE ISSUE

Pursuant to Rule 1-9(h) of this Court, defendants hereby set forth in support of their motion, in the alternative, for summary judgment the following statement of material facts as to which there is no genuine issue in this suit:

1. During 1978, Bankers Trust Company, New York, New York ("Bankers Trust"), a State-chartered member bank of the Federal Reserve System, began selling commercial paper issued by corporations not related to the bank ("third party commercial paper"). (R.6,9).*

* "R. __" refers to the administrative record maintained by the Board with respect to the petitions of Becker and the SIA concerning Bankers Trust's commercial paper activities. A copy of the record has been filed with the Court.

Defendants' Statement of Material Facts

2. In November 1978, A.G. Becker Incorporated ("Becker") and the Securities Industry Association (the "SIA") expressed concern to the staff of the Board of Governors of the Federal Reserve System (the "Board") regarding the legality of Bankers Trust's commercial paper activities. (R.6).

3. On June 29, 1979, after meetings between Board staff and the representatives of Becker and the SIA and after numerous written submissions by Becker, the SIA, Bankers Trust, and the General Counsel of the Securities and Exchange Commission (R.116-279, 283-320, 323-327, 329-335), the Board's General Counsel issued an opinion concluding that commercial banks may, subject to certain limitations, sell third party commercial paper. (R.336-361).

4. By letters to Becker and the SIA dated June 29, 1979, the Board's General Counsel stated that, at the request of either organization, he would recommend that the Board review his opinion. (R.360-361).

5. In submissions dated July 26, 1979, and January 31, 1980, respectively, the SIA and Becker requested that the Board review the General Counsel's opinion and initiate formal adjudicatory proceedings to restrain Bankers Trust's activities. (R.363-414, 554-558).

6. On September 26, 1980, the Board issued the attached statement and letter with respect to the petitions of Becker and the SIA. (R.662-692).

Respectfully submitted,

NEAL L. PETERSEN
General Counsel

JAMES V. MATTINGLY, JR.
Assistant General Counsel

/s/ RICHARD M. ASHTON

RICHARD M. ASHTON
Attorney
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551
(202) 452-3750

Counsel for defendants.

Plaintiff's Cross-Motion for Summary Judgment in Civil Action No. 80-2614 (D.D.C.)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2614

A.G. BECKER INCORPORATED,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

PLAINTIFF'S CROSS-MOTION
FOR SUMMARY JUDGMENT

Plaintiff, A.G. Becker Incorporated, ("A.G. Becker"), by its attorneys, Fried, Frank, Harris, Shriver & Kampelman, respectfully moves, pursuant to Rule 56 of the Federal Rules of Civil Procedure, that the Court enter summary judgment in its

favor declaring (1) that the September 26, 1980 final ruling and order (the "Ruling") by the Board of Governors of the Federal Reserve System (the "Board"), holding, as a matter of law, that commercial paper is not a security or a note within the meaning of the Glass-Steagall Act, 48 Stat. 162, and that member banks of the Federal Reserve System are not prohibited by Sections 16 and 21 of the Glass-Steagall Act from dealing in, distributing and underwriting third-party commercial paper, is arbitrary, capricious, an abuse of discretion, without any rational basis, in excess of the Board's statutory authority, and otherwise not in accordance with law and that the Ruling is null and void; (2) that the Board's Ruling refusing to initiate cease-and-desist proceedings against Bankers Trust Company in connection with its third-party commercial paper activities is arbitrary, capricious, an abuse of discretion, without any rational basis, in excess of the Board's statutory authority, and otherwise not in accordance with law and that the Ruling is null and void; and (3) that the Board's actions in connection with A.G. Becker's petition to the Board violated the Government in the Sunshine Act and the Administrative Procedure Act and deprived A.G. Becker of its right to due process of law.

A.G. Becker further respectfully moves for a permanent injunction ordering defendants, their successors, agents and employees, and other representatives to set aside and withdraw the Board's September 26, 1980 Ruling and enjoining them from implementing it or giving it any effect and remanding this action to the Board in order for it to determine whether to initiate cease-and-desist proceedings against Bankers Trust Company and other member banks in connection with their third-party commercial paper activities and further ordering the Board to comply with the Government in the Sunshine Act and the Administrative Procedure Act in connection therewith.

As grounds for this motion, A.G. Becker alleges that it is entitled to such declaratory and injunctive relief as a matter of law on the basis of material facts as to which there is no

genuine issue. The motion is supported by the pleadings, the administrative record before the Board, a Statement of Material Facts as To Which There Is No Genuine Issue, the Affidavit of Thomas R. York and a Memorandum of Points and Authorities In Support of Plaintiff's Cross-Motion for Summary Judgment, all of which are being filed herewith and are incorporated herein by reference.

Respectfully submitted,

/s/ HARVEY L. PITT
Harvey L. Pitt
Henry A. Hubschman
Edson G. Case, Jr.

Fried, Frank, Harris, Shriver
& Kampelman
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500

Attorneys for A.G. Becker Incorporated

Of Counsel:

Randy A. Harris
General Counsel
A.G. Becker Incorporated
2 First National Plaza
Chicago, Illinois
(312) 630-5000

Dated: February 27, 1981

SIA's Cross-Motion for Summary Judgment in Civil Action No. 80-2730 (D.D.C.)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2614

A.G. BECKER INCORPORATED,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Plaintiff Securities Industry Association's Cross-Motion for Summary Judgment

Pursuant to Rule 56(b), Federal Rules of Civil Procedure, plaintiff Securities Industry Association hereby moves for summary judgment in its favor, granting the relief as set forth in the annexed proposed Order on the ground that there are no

genuine issues of material fact and plaintiff is entitled to judgment as a matter of law.

In support of its motion, plaintiff respectfully refers the Court to the attached Statement of Material Facts As To Which Plaintiff Contends There Is No Genuine Issue; and to the attached Memorandum of Points and Authorities submitted by Plaintiff Securities Industry Association in Opposition to Defendant's Motion to Dismiss, or Summary Judgment, and in Support of Its Cross-Motion for Summary Judgment.

Respectfully submitted,

/s/ JOHN M. LIFTIN
John M. Liftin
James B. Weidner
Janet R. Zimmer
David A. Schulz
Thomas M. Shoesmith

ROGERS & WELLS
1666 K Street, N.W.
Washington, D.C. 20006
(202) 331-7760
Attorneys for the Securities Industry Association

Dated: February 27, 1981

SIA's Statement of Material Facts As to Which There is No Genuine Issue, filed in Civil Action No. 80-2730 (D.D.C.)

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2614

A.G. BECKER INCORPORATED,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Plaintiff Securities Industry Association's Statement of Material Facts as to Which There is No Genuine Issue

Pursuant to Rule 1-9(h) of this Court, plaintiff Securities Industry Association hereby sets forth, in support of its motion for summary judgment, the following statement of material facts as to which there is no genuine issue in this action:

SIA's Statement of Material Facts

1. During 1978, Bankers Trust Company, New York, New York ("Bankers Trust"), a State-chartered member bank of the Federal Reserve System, began selling commercial paper issued by corporations not related to the bank ("third-party commercial paper"). (R. 6, 9.)*

2. Sometime prior to July 26, 1978, Bankers Trust began distributing to commercial paper issuers sales materials (R. 67-106) in which Bankers Trust offered to expand the distribution of such issuers' commercial paper by acting as a seller of the paper. (R. 67, 69, 73). These sales materials discuss the "advantages of Bankers Trust versus . . . other dealers" (R. 86), including "a specialized sales distribution system that rivals that of dealers" (R. 72) and "a fee that is competitive with that of commercial paper dealers" (R. 87). In addition, Bankers Trust stated that it may, from time to time and without prior commitment, lend the issuer money and take back notes if unable to place all of that issuer's paper, a policy described as allowing Bankers Trust to be "completely competitive." (R. 82).

3. In November 1978, A.G. Becker Incorporated ("Becker") and the Securities Industry Association ("SIA") expressed concern to the staff of the Board of Governors of the Federal Reserve System ("Board") regarding the legality of Bankers Trust's commercial paper activities., (R. 6).

4. In two letters, dated April 20 and June 26, 1979, the Office of General Counsel of the Securities and Exchange Commission advised the Board of its opinion, based on its

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* "R. " refers to the administrative record maintained by the Board with respect to the petitions of A.G. Becker, Inc. and the Securities Industry Association concerning Bankers Trust's commercial paper activities. A copy of this record has been filed with the court.

analysis of the Act and its legislative history, that commercial paper was a "security" within the meaning of the Glass-Steagall Act. (R. 311-320; 329-335.) (Subsequently, by letter dated February 20, 1980 the Securities and Exchange Commission advised the Board that it had reviewed its General Counsel's analysis and concurred in the conclusion that commercial paper is a "security" as that term is used in the Glass-Steagall Act. (R. 559-560.))

5. On June 29, 1979 after a meeting between Board staff and representatives of Becker and the SIA and after numerous written submissions by Becker, the SIA, Bankers Trust, and the General Counsel of the Securities and Exchange Commission (R. 116-279, 283-320, 323-327, 329-335), the Board's General Counsel issued an opinion concluding that commercial banks may, subject to certain limitations, sell third-party commercial paper. (R. 336-361.)

6. By letters to Becker and the SIA dated June 29, 1979, the Board's General Counsel stated that, at the request of either organization, he would recommend that the Board review his opinion. (R. 360-361.)

7. In submissions dated July 26, 1979 and January 31, 1980, respectively, the SIA and Becker requested the Board to review the matter and to initiate formal adjudicatory proceedings to restrain Bankers Trust's activities. (R. 363-414, 554-558.)

8. On September 26, 1980, the Board issued a letter and statement setting forth its conclusion that "commercial paper is not a 'security' within the meaning of the Glass-Steagall Act. The restrictions of the Act against underwriting and dealing in securities thus do not apply to such an instrument." (R. 563.) The Board also expressed its view that "the sale of third party commercial paper by a commercial bank could involve, at least

in some circumstances, potential unsafe or unsound banking practices." (R. 664, 669.)

Dated: February 27, 1981

/s/ JOHN M. LIFTIN
John M. Liftin
James B. Weidner
Janet R. Zimmer
David A. Schulz
Thomas M. Shoesmith

ROGERS & WELLS
1666 K Street, N.W.
Washington, D.C. 20006
(202) 331-7760
Attorneys for the Securities Industry Association

Order of the Federal Energy Regulatory Commission, Docket No. EL81-5-000 (March 17, 1981)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ELECTRIC RATES: Interlocking Directorates

Before Commissioners: Georgiana Sheldon, Acting Chairman; Matthew Holden, Jr., George R. Hall and J. David Hughes.

Edison Electric Institute — Docket No. EL81-5-000

ORDER CONCERNING INTERLOCKING DIRECTORATES
(Issued March 27, 1981)

On December 8, 1980, the Edison Electric Institute (EEI) filed a petition calling to the Commission's attention certain questions relating to interlocking directorates raised by recent actions of the Board of Governors of the Federal Reserve System (Board).

Background

Section 305(b) of the Federal Power Act makes it unlawful, in the absence of Commission authorization, for any person to hold the position of an officer or director of a public utility and the position of an officer or director of a bank, trust company, banking association, or firm authorized to underwrite or participate in the marketing of public utility securities. Commercial banks are prohibited by the Glass-Steagall Act from underwriting or marketing securities,[1] and EEI indicates that, in reliance on the prohibitions found in the Glass-Steagall Act, many officers and directors of public utilities now serve as officers or directors of commercial banks without having obtained Commission authorization.

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1 Banking Act of 1933, ch. 89, 48 Stat. 162 (1933); Banking Act of 1935, ch. 614, 49 Stat. 684 (1935).

Order

In July of 1978, the Bankers Trust Company (Trust Company) placed third party commercial paper with certain institutional investors as agent for and on behalf of certain unidentified corporate issuers.[2] The Securities Industry Association (SIA) and A.G. Becker, Inc. (Becker) subsequently requested the Board to review the legality of the Trust Company's actions, alleging *inter alia* that the Trust Company was dealing in securities in violation of the applicable provisions of the Glass-Steagall Act. On September 26, 1980, the Board concluded *inter alia* that commercial paper is not a security within the meaning of the Glass-Steagall Act and that the Trust Company had not violated the applicable provisions of the Glass-Steagall Act.

The SIA and Becker have each filed for review of the Board's finding in the United States Court of Appeals for the District of Columbia Circuit and in the United States District Court for the District of Columbia. The SIA also has filed suit against the Trust Company seeking a declaratory judgment and an injunction in the United States District Court for the Southern District of New York.

As a result of these events, EEI seeks an order of this Commission declaring that it will take no immediate action against individuals serving both as officers or directors of public utilities and officers or directors of commercial banks in response to the Board's determination and that the *status quo ante* will be maintained pending the outcome of the ongoing litigation. EEI believes that any ultimate determination by the Commission should be deferred.

Notice of EEI's petition was issued on January 23, 1981, with responses due on or before February 3, 1981. No responses have been filed.

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2 The commercial paper placed by the Trust Company was not issued by the Trust Company but was issued by corporations not related to the Trust Company; the Trust Company thus is said to have placed third party commercial paper.

Discussion

While commercial banks long have engaged in and continue to engage in the purchase and, less frequently, the sale of commercial paper for their own accounts or for the accounts of their customers,[3] the Trust Company's placement of third party commercial paper departs from commercial banks' traditional role in the commercial paper markets. The Trust Company acted as agent for the issuer, "marketing" commercial paper much like a commercial paper dealer.

The Commission consistently has held that Section 305(b) of the Federal Power Act requires Commission authorization to hold interlocks between public utilities and commercial banks only when commercial banks are authorized by law to underwrite or participate in the marketing of public utility securities.[4] Now, for the first time, commercial banks appear to be "authorized by law to underwrite or participate in the marketing of securities of a public utility" for purposes of section 305(b): the Board's finding appears to authorize commercial banks to "market" third party commercial paper and it appears that, given the broad definition of "security" found in the Federal Power Act,[5] commercial paper is a security for purposes of section 305(b). As a result, the hundreds of public

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3 *Bankers Trust Company*, Findings of the Board of Governors of the Federal Reserve System and Statement Regarding Petitions to Initiate Enforcement Action (September 26, 1980). *See Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971). *See generally* E. Hurley, The Commercial Paper Market, 63 Fed. Res. Bull. 525 (1977).

4 *Arthur F. Davey*, 2 FPC 534 (1939). *See* 55 FPC Ann. Rep. 4 (1975); 54 FPC Ann. Rep. 6 (1974).

5 Section 3(16) of the Federal Power Act provides:

> "security" means any note, stock, treasury stock, bond, debenture, or other evidence of interest in or indebtedness of a corporation subject to the provisions of this Act. 16 U.S.C. § 796(16) (1976).

See also 16 U.S.C. § 824c (1976).

utility officers and directors also serving as commercial bank officers and directors may be in violation of section 305(b). To continue to hold the interlocks, Commission authorization is required.

The abrupt change in the status of those persons now serving as officers or directors of public utilities and officers or directors of commercial banks, coupled with the number of persons affected, persuades the Commission that action is warranted pending the outcome of the ongoing litigation and final Commission resolution. In view of the unique circumstances now before us, we believe it appropriate to authorize the continued holding of such positions on an interim basis, but only if the subject commercial banks have not underwritten or marketed and do not now underwrite or market public utility securities, including commercial paper. It appears that a clear, overriding benefit is to be gained from temporarily authorizing the continued holding of such positions, and that neither public nor private interests will be adversely affected. Moreover, we believe that the sudden change in the status of these individuals and the number involved present good cause to depart from the requirements of Part 45 of our regulations. Accordingly, we shall waive the requirements of Part 45 of our regulations. We shall instead require those persons who seek to take advantage of the interim authorization afforded by our order to file an abbreviated statement identifying the affected interlocks.

Where, however, the subject commercial banks have underwritten or marketed, are now underwriting or marketing, or in the future underwrite or market public utility securities, including commercial paper, those persons holding interlocks must individually seek Commission authorization pursuant to section 305(b) and Part 45 of our regulations. The potential harms sought to be eliminated by the enactment of section 305(b) are most likely to occur when the underwriting or marketing of public utility securities actually takes place;[6] we, therefore, do

6 *See John Edward Aldred*, 2 F.P.C. 247 (1940).

not believe that even interim authorization should be granted in such cases.[7]

Finally, we caution that this interim determination should not be construed as precluding any further action which the Commission may deem warranted as circumstances develop, or as prejudging any substantive questions that subsequently may be presented.

The Commission orders:

(A) Until further order of this Commission, any person now holding or who may hold the positions of officer or director of a public utility and officer or director of a bank subject to the provisions of the Glass-Steagall Act is authorized to hold such positions on an interim basis; *Provided that* the subject bank has not engaged in and does not now engage in, the underwriting or marketing of securities of a public utility, including the commercial paper of a public utility; and *Provided, further*, that such person files the statement required in Paragraph (C) below.

(B) Until further order of this Commission, no person now holding or who may hold the positions of officer or director of a public utility and officer or director of a bank subject to the provisions of the Glass-Steagall Act is authorized to hold such positions if the bank has engaged in, does now engage in, or does in the future engage in the underwriting or marketing of securities of a public utility, including the commercial paper of a public utility, unless that person has obtained authorization to hold such positions pursuant to section 305(b) of the Federal Power Act and Part 45 of the Commission's regulations. 18 C.F.R. Part 45 (1980). Persons now holding such positions and who wish to continue to hold such positions shall file an

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7 Provided that timely applications are filed with respect to this matter, the Commission will not require that the applicants remove themselves from their positions during the pendancy of their applications.

application for authorization under Part 45 of the Commission's regulations within forty-five days.

(C) The requirements of Part 45 of the Commission's regulations are hereby waived with respect to those persons subject to Paragraph (A) above, and those persons, instead, shall file, in conjunction with the statement required by section 305(c) of the Federal Power Act, a statement providing the following information:

(1) full name, business address, and place of residence;

(2) public utilities with which the person holds the positions of officer or director, and identifying those positions;

(3) banks subject to the provisions of the Glass-Steagall Act with which the person holds the positions of officer or director, and identifying those positions.

(D) This order shall not affect the liability of any person under section 305(a) of the Federal Power Act or under any other provision of that Act.

(E) The Secretary shall promptly publish this order in the Federal Register.

By the Commission.

(SEAL)

/s/ KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

Order of the Federal Energy Regulatory Commission, Docket No. EL81-5-000 (May 26, 1981)

15 FERC ¶ 61-173

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Electric Rates: Rehearing; Intervention; Interlocking Directorates

Before Commissioners: Georgiana Sheldon, Acting Chairman; Matthew Holden, Jr., and J. David Hughes.

Edison Electric Institute Docket No. EL81-5-000

ORDER GRANTING INTERVENTION, GRANTING REHEARING FOR PURPOSE OF RECEIVING FURTHER COMMENTS, AND CLARIFYING PRIOR ORDER
(Issued May 26, 1981)

By order issued March 27, 1981, the Commission determined that persons serving as officers or directors of public utilities and officers or directors of commercial banks were authorized to hold such positions upon a minimal filing provided that the subject banks did not engage in the underwriting or marketing of public utility securities, including commercial paper. If, however, the subject banks engaged in underwriting or marketing public utility securities, including commercial paper, such persons were required to seek individual authorization pursuant to Part 45 of the Commission's regulations. 18 C.F.R. Part 45 (1980).

On April 10, 1981, the Continental Illinois National Bank and Trust Company of Chicago (CINB) petitioned to intervene out of time. On April 24, 1981, CINB filed an application for rehearing. CINB states that it is a commercial bank with two directors who also serve as directors of public utilities and that it has numerous relationships with public utilities subject to the

Commission's jurisdiction. CINB argues that it did not receive adequate notice of this proceeding and so it did not previously petition to intervene. The comments and analysis of CINB and of the commercial banking industry, CINB submits, would have been and will be of great benefit to the Commission in this proceeding. Moreover, CINB argues that the Commission improperly determined that commercial banks are authorized to underwrite or market public utility securities and that the Commission's authority thus extends to interlocks between public utilities and commercial banks. Finally, CINB argues that the holding of such interlocks does not adversely affect public or private interests. CINB asks in the alternative that the Commission (1) reverse its order of March 27, 1981 and find that commercial banks are not authorized to underwrite or market public utility securities; (2) vacate its order of March 27, 1981 and permit all interested parties to address the merits of the questions before the Commission; or (3) stay its order of March 27, 1981 until the actions now ongoing in the courts are resolved.

We find that CINB's participation in this proceeding is in the public interest and that good cause exists to grant the untimely petition. Accordingly, we shall grant CINB's petition to intervene out of time. In this instance, we also believe that further input from interested persons should be permitted. CINB has requested an opportunity to comment further on the structure of the commercial banking industry and how it would be affected by our order of March 27, 1981 in this proceeding. *Because the commercial banking industry is one with which the Commission does not ordinarily have direct involvement*, we believe that it is appropriate to grant CINB's request to comment further and to afford an additional opportunity for comment to all interested persons. Accordingly, we shall invite interested persons, whether or not parties, to file responses to the application for rehearing or additional comments on our prior order in the form of briefs, to be submitted within forty-five days of the issuance of this order.

Order

We shall further amend our prior order to resolve the ambiguities that may have resulted and to clarify the Commission's intent, particularly with regard to the filing requirement found in ordering paragraph (C) of that order. These clarifications also respond to allegations of a technical violation of the Paperwork Reduction Act of 1980.

The Commission orders:

(A) The petition to intervene is hereby granted subject to the rules and regulations of the Commission; *provided, however*, that participation by the intervenor shall be limited to matters set forth in its petition to intervene; and *provided, further*, that the admission of the intervenor shall not be construed as recognition by the Commission that it might be aggrieved because of any order or orders by the Commission entered in this proceeding.

(B) The application for rehearing is hereby granted for purposes of further hearing. Responses to the application for rehearing and additional comments on the order issued March 27, 1981 in this proceeding are invited from any interested persons, whether or not parties, within 45 days of the issuance of this order.

(C) Ordering paragraphs (A), (B), and (C) of the Commission's order issued March 27, 1981 in the instant docket are hereby amended to read as follows:

> (A) Until further order of this Commission, any person holding the positions of officer or director of a public utility and officer or director of a bank subject to the provisions of the Glass-Steagall Act is authorized to hold such positions on an interim basis; *provided* that the subject bank does not engage in the underwriting or participate in the marketing of securities of a public utility, including commercial paper; and *provided, further*, that such person files the statement required in Paragraph (C) below.

Order

(B) Until further order of this Commission, no person holding the positions of officer or director of a public utility and officer or director of a bank subject to the provisions of the Glass-Steagall Act is authorized to hold such positions if the subject bank engages in the underwriting or participates in the marketing of securities of a public utility, including commercial paper, unless that person has obtained authorization to hold such positions pursuant to section 305(b) of the Federal Power Act and Part 45 of the Commission's regulations. Those persons who wish to continue to hold such positions shall file an application for authorization pursuant to Part 45 of the Commission's regulations within either forty-five days of the date the subject bank engages in the underwriting or participates in the marketing of securities of a public utility, including commercial paper, or within 45 days of the date of issuance of this order, whichever is later.

(C) Until further order of this Commission, the full requirements of Part 45 of the Commission's regulations, except as required below, are hereby waived with respect to those persons subject to Paragraph (A) above. In lieu of the full requirements of Part 45 of the Commission's regulations, those persons shall file an application providing only the following information:

(1) full name and business address;

(2) all public utilities with which the person holds the positions of officer or director, and identifying those positions;

(3) all banks subject to the provisions of the Glass-Steagall Act with which the person holds the positions of officer or director and identifying those positions.

Order

(C) The Secretary shall promptly publish this order in the Federal Register.

By the Commission.

(SEAL)

/s/ KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

Board Press Release, dated May 28, 1981

FEDERAL RESERVE PRESS RELEASE

May 28, 1981

For immediate release

The Federal Reserve Board has adopted a policy statement providing guidelines to govern the sale by State member banks of commercial paper issued by firms not related to the bank.

The Board's guidelines concerning the sale of such third party commercial paper (promissory notes of corporations) are intended to assure safe and sound banking practices. The Board said it would monitor activity in this area closely and would modify or supplement its guidelines as indicated by experience.

The policy statement is effective immediately. However, the Board will accept comment, for review by the Board, through July 31, 1981.

The policy statement calls for:

—Limitation of sales to prime quality commercial paper meeting specifications in the statement.

—Careful analysis and monitoring by the seller of the creditworthiness of the issuer.

—Adoption by the selling bank of rules limiting the amount of commercial paper that may be sold for single or related issuers.

—Extensive record keeping and maintenance of records.

—No sales to fiduciary accounts over which the bank has investment discretion, or to the bank's parent bankholding company (unless it is a bank) or to a nonbank affiliate of the bank.

—Certain notices to buyers.

These guidelines are spelled out in the attached statement.

Attachment

Federal Reserve System, *Policy Statement Concerning the Sale of Third-Party Commercial Paper by State Member Banks,* dated May 26, 1981

POLICY STATEMENT CONCERNING THE SALE OF THIRD PARTY COMMERCIAL PAPER BY STATE MEMBER BANKS

[Docket No. R-0360]

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy Statement

SUMMARY: Pursuant to its authority to restrain unsafe or unsound banking practices by State member banks, the Board of Governors of the Federal Reserve System adopts a policy statement setting forth guidelines governing the sale by a State member bank of commercial paper of issuers not related to the bank ("third party commercial paper"). The guidelines reflect the Board's judgment that certain practices may develop in the sale by a bank of third party commercial paper that may not be consistent with the principles of safe and sound banking. The guidelines concern the type and amount of commercial paper that should be sold, the kinds of records that should be maintained, and the purchasers to which such paper may be sold. The Board intends to monitor closely the activities of State member banks in this area and may modify or supplement this policy statement based on the Board's review of the experience of State member banks in conducting these activities.

EFFECTIVE DATE: May 26, 1981. Interested parties may submit comments on the policy statement that will be reviewed by the Board. Comments must be received on or before July 31, 1981.

ADDRESS: Comments should include reference to Docket No. R-0360 and should be mailed to the Secretary, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223, 20th and Constitution Avenue, N.W., Washing-

ton, D.C. between 8:45 a.m. and 5:15 p.m. Comments may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, (202) 452-2782, or Richard Ashton, Senior Counsel, Legal Division, (202) 452-3750, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTAL INFORMATION: On September 26, 1980, the Board took action with respect to the petitions of the Securities Industry Association (the "SIA") and of A.G. Becker Incorporated ("A.G. Becker") that the Board prohibit Bankers Trust Company, New York, New York ("Bankers Trust"), a State member bank, from selling third party commercial paper. The Board denied the petitions to the extent they alleged that Bankers Trust's commercial paper activities violate the Glass-Steagall Act or should be prohibited by general considerations of public policy. The Board also stated that the sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, potential unsafe or unsound practices. The Board thus took no action on the petitions' allegations of dangers to Bankers Trust or potential conflicts of interest pending development of general supervisory guidelines designed to avoid potential unsafe or unsound practices in the sale of third party commercial paper by State member banks.

In developing the guidelines that are set forth in the following policy statement, the Board has consulted with the staffs of the other federal banking agencies and has considered the allegations of unsafe practices made by the SIA and A.G. Becker and the comments of the Securities and Exchange Commission.

With respect to the possibility that a bank's commercial paper selling activities may lead the bank into investing its funds in imprudent investments, the Board recognizes that a bank's selling activity may result in the purchase of some commercial paper with the bank's own funds. However, the Board notes that banks have traditionally been permitted to purchase commercial paper for their own account and such

purchases have been treated for supervisory purposes as commercial loans. In addition, since only large, well-known corporations with established credit ratings are able to market unsecured obligations, commercial paper is generally a low-risk instrument, even relative to some commercial loans.[1] Furthermore, the Board's guidelines provide that a bank should sell only prime quality paper and make a thorough credit analysis of each issuer and that all commercial paper sold by the bank should be fully supported by available lines of credit.[2] These guidelines would also minimize the danger that a bank selling commercial paper might be tempted to make unsound loans to an issuer which is encountering financial difficulties in order to protect the bank's reputation.

The SIA, A.G. Becker, and the SEC have also raised the possibility of loans by a selling bank to facilitate purchase of commercial paper being sold by the bank. However, because rates on commercial paper are usually lower than rates charged on bank loans, the use of borrowed funds to purchase commercial paper would be unprofitable and thus unlikely. Accordingly, there does not appear to be any practical substance to this concern.

Another potential hazard cited in connection with bank sales of commercial paper is the possibility that the bank's salesman's interest might impair its existing obligations to its customers and might consequently damage the bank's good will and reputation. In particular, it is claimed that bank depositors might suffer losses on paper purchased from the bank, that "the bank's reputation for prudence and restraint would be abused," that the bank would lose its ability to provide disinterested investment advice, and that the bank

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1 The Board notes that, at least on some occasions, significant losses have been suffered by commercial paper purchasers, for example, the 1970 collapse of Penn Central Transportation Company. However, banking functions, such as commercial lending, also involve some degree of risk and losses can and do occur.

2 A selling bank could only participate in the line of credit up to the amount of its legal lending limit.

might "unload" worthless commercial paper in its trust department.

Under the Board's guidelines, however, a bank may sell commercial paper only to financially sophisticated purchasers and may not advertise commercial paper for sale to the general public. Thus, there appears to be little likelihood that any but a small fraction of a bank's depositors would even consider purchasing commercial paper being sold by the bank. For the same reason, the potential for a bank abusing its reputation for "prudence and restraint" in selling commercial paper does not appear significant. Finally, with respect to potential inability to provide disinterested investment advice and "unloading" of worthless commercial paper in the bank's trust accounts, the guidelines provide that the bank should not sell commercial paper to fiduciary accounts over which the bank has investment discretion.

The Board intends to monitor closely the selling activities of Bankers Trust and any other State member bank that may initiate such services. Based on further experience in this area, the Board may modify or supplement these guidelines to assure that such activities are conducted in accordance with principles of safe and sound banking.

Accordingly, acting pursuant to its supervisory authority over State member banks contained in section 9 (12 U.S.C. 321, *et seq.*) and section 11 (12 U.S.C. 248) of the Federal Reserve Act and the Financial Institutions Supervisory Act of 1966 (12 U.S.C. 1818(b)) and related provisions of law, the Board of Governors adopts the following policy statement.

Policy Statement Concerning Sale of Third Party Commercial Paper by State Member Banks

The Board of Governors has recently determined that the sale of commercial paper by a State member bank for unaffiliated issuers ("third party commercial paper")[3] did not violate

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3 Excluding commercial paper issued by a parent bank holding company; the Board has previously advised bank holding companies concerning sales of bank holding company commercial paper (letter dated June 27, 1980).

the Glass-Steagall Act (12 U.S.C. §§ 24, Seventh, 378). The Board was concerned however, that the sale of third party commercial paper[4] might, in some circumstances, involve unsafe or unsound practices. Accordingly, in the interest of safe and sound banking, the Board believes that any State member bank that may decide to engage in the sale of third party commercial paper should adhere to the following guidelines.[5]

1. A State member bank should sell only prime quality commercial paper that qualifies for the exemption provided by section 3(a)(3) of the Securities Act of 1933 (15 U.S.C. 77c(a)(3)). The bank should take appropriate precaution to assure itself that the section 3(a)(3) exemption applies to the commercial paper it proposes to sell. In this regard, (i) the bank should determine that the commercial paper it proposes to sell is of prime quality; (ii) the bank may rely on representations of the issuer with respect to the use of proceeds; (iii) except as further limited by paragraphs 7 and 8, the bank should sell commercial paper only to financially sophisticated customers, such as customers that regularly purchase a variety of short-term credit instruments, and should not advertise commercial paper for sale to the general public; (iv) the bank should obtain periodically, and maintain in the bank's records, a current legal opinion of counsel that the section 3(a)(3) exemption is available. In addition, the bank should sell commercial paper in minimum denominations that are consistent with applicable law and, in no event, should sell commercial paper in minimum denominations of less than $100,000

2. The selling bank should maintain a complete credit analysis of the issuer at all times and should exercise due diligence

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4 Banks have traditionally purchased commercial paper upon the order, and for the account of, customers, whereas here the bank is essentially acting for the issuer; the former activity is not subject to the guidelines set forth in this Policy Statement.

5 The Board does not expect to take enforcement action to restrain unsafe or unsound banking practices with respect to third-party commercial paper selling activities of any State member bank that conducts such activities within these guidelines.

in investigating the financial affairs of the issuer. Particular attention should be given to the liquidity position of the issuer and its lines of credit. All commercial paper sold by the bank should be fully supported by available lines of credit. Any participation by the selling bank in such lines of credit should be made only after consideration of the bank's legal lending limit.

3. Senior management should adopt internal limits for the amount(s) of commercial paper that may be sold by the bank for a single or related issuer(s). In determining the internal limits, senior management should consider the financial condition of the issuer, all lines of credit available to the issuer, and the bank's participation in the lines of credit and any other extensions of credit or commitments to the issuer by the bank (including commercial paper purchased by the bank for its own account.)

4. Chronological records of original entry should be maintained that contain an itemized daily record of all sales and purchases of commercial paper. The records should also contain:

- A designation of the commercial paper,
- nature of the transaction, *e.g.* purchase or sale,
- trade and settlement dates,
- contra-party name or designation,
- net proceeds, discount rate, or yield to maturity.

5. Account records should be maintained for each issuer that reflect:

- All sales and purchases of commercial paper placed by the bank for that issuer,
- all lines of credit available to the issuer,
- the amount of the bank's participation in the lines of credit,
- a current balance of all extensions of credit and a description of other commitments to the issuer.

Policy Statement

6. Account records should be maintained for each purchaser that reflect all sales and purchases of commercial paper for the account of that customer.

7. Commercial paper should not be sold to fiduciary accounts over which the bank has investment discretion.

8. Commercial paper should not be sold to the bank's parent holding company (unless it is a bank) or any nonbank affiliate of the bank.

9. The bank should furnish to all purchasers of commercial paper written advice in connection with all purchases that (1) the commercial paper is not an obligation of the bank, and is not insured by the FDIC, (2) the bank has no obligation to repurchase any of the paper sold, (3) the bank is under no obligation to lend funds to the issuer (except pursuant to existing credit lines, or other commitments, if any), and (4) copies of the issuer's most recently published financial statements will be furnished upon request.

By order of the Board of Governors, May 26, 1981.

(signed) James McAfee

James McAfee
Assistant Secretary of the Board

(SEAL)

Excerpts from Transcript of Oral Argument in Civil Action No. 80-2730 (D.D.C.) on July 18, 1981 before Hon. Joyce Hens Green [pages 1-2, 16-17]

IN THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-2614

A. G. BECKER, INC.,

Plaintiffs,

vs.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Civil Action No. 80-2730

SECURITIES INDUSTRY ASSOCIATION,

Plaintiffs,

vs.

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,

Defendants.

Washington, D.C.
Thursday, June 18, 1981

The above-entitled matter came on for hearing before the Honorable JOYCE HENS GREEN, United States District Judge, commencing at approximately 10:00 a.m.

Transcript of Oral Argument

APPEARANCES:

On behalf of A. G. Becker, Inc.:

HARVEY L. PITT, Esquire
HENRY A. HUBSCHMAN, Esquire
EDSON G. CASE, Esquire

PROCEEDINGS

THE DEPUTY CLERK: Civil Action 80-2614, A.G. Becker, Inc. versus the Board of Governors of the Federal Reserve System, et al., and Civil Action 80-2730, the Securities Industry Association versus the Board of Governors of the Federal Reserve System, et al.

MR. ASHTON: Good morning, Your Honor.

THE COURT: Good morning.

MR. ASHTON: May it please the Court.

My name is Richard Ashton, and I'm an attorney with the Federal Reserve Board. I will be presenting all argument this morning on behalf of the Board in support of its motions to dismiss, or in the alternative, for summary judgment in these cases, A. G. Becker versus the Board of Governors and the Securities Industry Association versus the Board of Governors.

THE COURT: Would you like to introduce the people who are at counsel table with you.

MR. ASHTON: Yes, I would.

Sitting at the counsel table with me are J. Virgil Mattingly, Jr., Associate General Counsel, and Melanie L. Fein, who is an attorney on the staff of the Federal Reserve Board also.

The arguments in this case have been exhaustively briefed in the numerous papers filed in this case. I would

[material deleted]

regularly as part of their business. As the Board found, the record indicates that the transaction represented by Bankers Trust, the commercial paper sold by Bankers Trust meets these criteria. It's undisputed that the paper is short term.

The record indicates that the average maturity of this paper is around 60 days. It's also clear that there are relatively few lenders, and no more than 15 in the case of any one particular issue, and Bankers Trust sells commercial paper in very large denominations, large enough so that an average investor would be unable to purchase them. The record indicates that the average denomination on the commercial paper Bankers Trust sells, is around a million dollars, minimum denomination.

And finally, the record indicates that the purchasers of the commercial paper from Bankers Trust are part of the bank's established base of institutional purchasers, who regularly purchase short term credit obligations, and thus are regularly extending credit. They are the functional equivalent of lenders.

Put another way: The Board found that Bankers Trust activity in selling the commercial paper is functionally the same as a bank's activities in selling loan notes in connection with a loan participation.

It's crucial to note that the Board's analysis here depends on the combination of all the particular facts involved. The Board did not say that any one particular fact was determinative. The Board didn't say that all short term notes were not securities, it didn't say that all nonspeculative notes were not securities. The Board's determination is based on this particular combination of the factors involved. If the factors change, for example, if Bankers Trust began selling commerical paper in very small denominations or marketing it to the public, then the Board's conclusion is very likely to change.

The plaintiffs have tried to attack this functional finding by the Board by alleging that since Bankers Trust activity involves a marketing activity, it must be a security, but as we demonstrated, of course, the extent to which marketing is involved, is to some extent relevant. If the commercial paper were marketed widely, it might be a security, but the marketing activity here is limited, it's limited to an narrow class of customers, customers that are functionally equivalent to lenders.

And finally, the Glass-Steagall Act does not prohibit banks from engaging in marketing activities. It prohibits them from underwriting marketing securities. The Board's finding that commercial paper is not a security for purposes of the Glass-Steagall Act, is bolstered by its finding that commercial paper does not meet the statutory definition of investment security in Section 16.

Opinion of the United States District Court

UNITED STATES DISTRICT COURT
DISTRICT OF COLUMBIA

Civ. A. Nos. 80-2614, 80-2730

July 28, 1981

A.G. BECKER INCORPORATED,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Defendants.

APPEARANCES:

Harvey L. Pitt, Henry A. Hubschman, Edson G. Case, Jr., Fried, Frank, Harris, Shriver & Kampleman, Washington, D.C., for Becker.

John M. Liftin, James B. Weidner, Janet R. Zimmer, Rogers & Wells, Washington, D.C., for SIA.

Richard M. Ashton, Neal L. Petersen, James V. Mattingly, Jr., Federal Reserve Board, Washington, D.C., for defendants.

JOYCE HENS GREEN, *District Judge.*

Pending before the Court in these consolidated actions are the parties' cross motions for summary judgment and the defendant's alternative motion to dismiss, with supporting memoranda. Plaintiffs are A.G. Becker, Inc. ("Becker"), a securities broker and dealer registered with the Securities and Exchange Commission, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers. They challenge a decision of the Board of Governors of the Federal Reserve System ("the Board"), which, with its individual members, are the defendants in this action. The dispute presents provocative questions concerning the delicately balanced regulatory system enacted by Congress to control the activities of the nation's banks in financial markets.

In the summer of 1978, Bankers Trust Company ("Bankers Trust"), a state chartered member bank of the Federal Reserve System, began offering for sale third party commercial paper, that is, commercial paper issued by corporations not related to the bank.[1] This effort included a marketing campaign aimed at

1 A succinct definition of commercial paper is offered in Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi. L. Rev. 362 (1972):

> Commercial paper consists of unsecured, short-term promissory notes issued by sales and personal finance companies; by manufacturing, transportation, trade, and utility companies; and by the affiliates and subsidiaries of commercial banks. The notes are payable to the bearer on a stated maturity date. Maturities range from one day to nine months, but most paper carries an original maturity between thirty and ninety days. When the paper becomes

issuers of commercial paper, whereby Bankers Trust agreed to act as a seller of commercial paper, performing services competitive with securities dealers. As part of this advertising, Bankers Trust offered to lend the issuer of commercial paper money equal to the amount of paper to be sold and, if the bank were unable to sell all of the issuer's paper, to take back notes reflecting the amount of paper unsold.

Becker and SIA expressed concern to the staff of the Board of Governors as to the legality of Bankers Trust's actions in a letter sent in November, 1978. Following this correspondence, plaintiffs, along with the General Counsel of the Securities and Exchange Commission ("SEC") and Bankers Trust, filed memoranda arguing over whether the sale by Bankers Trust of third party commercial paper violated certain provisions of the Banking Act of 1933 known as the Glass-Steagall Act. On June 28, 1979, after a meeting with representatives of Becker and SIA, the General Counsel of the Board issued a document entitled "Commercial Paper Activities of Commercial Banks: A Legal Analysis," which concluded that state member banks may, subject to certain limitations, sell third party commercial paper. The General Counsel offered, upon request by Becker or SIA, to recommend that the Board review his opinion. SIA, on July 26, 1979, and Becker, on January 31, 1980, requested that the Board review the General Counsel's opinion and that, in connection with that review, they initiate proceedings against Bankers Trust for violating the Glass-Steagall Act.[2]

> due, it is generally rolled over—that is, reissued—to the same or a different investor at the market rate at the time of maturity.

Id. at 363-64 (footnotes omitted).

2 Because it may affect the jurisdiction over this action, the parties dispute vigorously whether plaintiffs requested that the Board initiate cease and desist proceedings. Suffice it to quote from plaintiffs' precise language:

> This application is intended to . . . renew the SIA's request for formal action by the Board requiring Bankers Trust Company to cease and desist from its illegal activities. (Application of SIA for Review of State Member Bank Action, July 26, 1979 at 3; Record at

The Board took up the matter presented by the Becker and SIA petitions and, on September 26, 1980, issued a letter and a Statement Regarding Petitions to Initiate Enforcement Actions declaring that commercial paper was not a security within the meaning of the Glass-Steagall Act and that therefore Bankers Trust could legally sell third party commercial paper. The Board expressed concern at some potentially unsound practices that might have developed as a result of its ruling, and therefore commenced the drafting of guidelines governing the sale by state member banks of commercial paper.[3] Soon thereafter, the plaintiffs commenced this action seeking judicial review of the Board's conclusion that Bankers Trust was acting

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> 366) (Citations to the administrative record will be made as "R. at __").
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> . . . Applicant SIA respectfully asserts that the Board should (1) formally review this matter, (2) Order Bankers Trust to cease and desist from its third party commercial paper activity . . . *Id.* at 20, R. at 383.
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> . . . this memorandum is submitted to urge the Board . . . to advise Bankers Trust that its current commercial paper marketing activities are inappropriate as a matter of law and policy, and should cease. (Memorandum on Behalf of A. G. Becker Incorporated to the Staff of the Board of Governors of the Federal Reserve System Concerning the Commercial Paper Activities of Bankers Trust Company, January 31, 1980 at 3, R. at 154) The advance of Bankers Trust into the commercial paper market exceeds the boundary of any fair interpretation of where Congress intended the line to be drawn. We respectfully urge the Board, in conformity with the provisions of the Glass-Steagall Act, to issue a declaration to that effect. *Id.* at 47, R. at 198.

The petition submitted by Becker on January 31, 1979, was referred to in their letter exactly one year later seeking review of the General Counsel's opinion.

3 These guidelines were issued in the context of a policy statement on May 28, 1981, effective immediately, to govern the sale of third party commercial paper by state member banks. The Board indicated that it would accept comments on the guidelines through July 31, 1981, and that it will monitor the activities of banks in the commercial paper market to permit modification or supplementation of the guidelines as experience suggests may be fruitful. Plaintiffs' challenge to the Board's action does not include an attack on these guidelines.

within the parameters of the Glass-Steagall Act in offering for sale third party commercial paper.[4]

Surfacing intially in this controversy is the question whether this court, or any court, has jurisdiction to hear this dispute and grant plaintiffs their requested relief. It is beyond dispute that agency action is reviewable absent a showing that Congress specifically and clearly intended to preclude judicial oversight. The Board in this case has the burden of demonstrating that its decision to permit state member banks to sell third party commercial paper is insulated from review. *See Dunlop* v. *Bachowski*, 421 U.S. 560, 567, 95 S. Ct. 1851, 1857, 44 L. Ed. 2d 377 (1975); *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970); *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 140 n.2, 87 S. Ct. 1507, 1511, 18 L. Ed. 2d 681 (1967). In *Independent Bankers Association of America* v. *Board of Governors of the Federal Reserve System*, 500 F.2d 812 (D.C. Cir. 1974), the Court of Appeals declared that "non-reviewability must be established by a clear showing

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4 Prior to the filing of this action challenging the substance of the Board's ruling, Becker sought relief in this Court for alleged violations by the Board of the Government in the Sunshine Act, 5 U.S.C. § 552b. On November 26, 1980, this Court issued a memorandum opinion containing a declaratory judgment that the defendants violated the Act's premeeting notice requirements but finding that in all other respects, the Board had acted lawfully. That decision, *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 502 F. Supp. 378 (D.D.C. 1980), *appeal docketed*, May 4, 1981, will be referred to as *Becker* I.

Additionally, Becker filed, concurrently with this action, a petition in the Court of Appeals for the District of Columbia Circuit, *A. G. Becker, Inc.* v. *Board of Govenors of the Federal Reserve System*, No. 80-2258 (D.C. Cir., filed Oct. 14, 1980), seeking review of the Board's determination that the sale by state member banks of third party commercial paper did not violate the Glass-Steagall Act. The actions were filed in both courts pursuant to the suggestion in the Court of Appeals that "[i]f any doubt as to the proper forum exists, careful counsel should file suit in both the court of appeals and the district court . . . ." *Investment Company Institute* v. *Board of Governors*, 551 F.2d 1270, 1280 (D.C. Cir. 1977). Becker's motion to stay its action in the Court of Appeals is pending.

of Congressional intent to preclude review." *Id.* at 814. Especially where an agency has resolved a pure question of law, which the Board did when it decided that commercial paper was not subject to the proscriptions of the Glass-Steagall Act,[5] courts have a special competence and judicial review is clearly the norm. *See Natural Resources Defense Council, Inc.* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1048 (D.C. Cir. 1979).

The Board contends that the availability of judicial review is governed by the Financial Institutions Supervisory Act of 1966, as amended, which established procedures for the issuance of cease and desist orders by federal agencies with authority over the banking industry. Alternatively, it maintains that its refusal to commence enforcement proceedings against Bankers Trust is a matter committed to its discretion by law and therefore nonreviewable under the Administrative Procedure Act. The plaintiffs strenuously reject that Congess has entrusted the Board with absolute discretion over this matter, suggesting that the Board's interpretation of the Glass-Steagall Act is subject to the normal presumption favoring judicial review absent a showing by the Board of clear deprivation of the Court's jurisdiction. Neither ground for nonreviewability cited by the Board, plaintiffs contend, overcomes the doctrine that permits courts to review agency decision on questions of law.

The Board's initial authority for its argument that jurisdiction lacks is the Financial Institutions Supervisory Act of 1966, as amended, specifically 12 U.S.C. §§ 1818(h), (i). This legislation established procedures for the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board to regulate the nations financial houses and to enforce against

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5 Even the Board recognized that its conclusions necessitated a resolution of a legal question. *See* Letter to plaintiffs' counsel, September 28, 1980 at 3, R. at 664 (". . . the issues involved in these petitions are primarily legal in nature . . . "); Statement Regarding Petitions to Initiate Enforcement Actions, September 28, 1980, at 28, R. at 692 (". . . the Glass-Steagall Act issues resolved by the Board are essentially legal in nature . . . ").

unsafe or unsound banking practices. It provides, in pertinent part:

> (h)(2) . . . any person required by an order issued under this section to cease and desist from any of the violations or practices stated therein, may obtain a review of any order . . . by the filing in the court of appeals of the United States for the circuit in which the home office of the bank is located, or in the United States Court of Appeals for the District of Columbia Circuit . . . a written petition praying that the order of the agency be modified, terminated, or set aside . . . .
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> . . .
>
> (i)(1) The appropriate Federal banking agency may in its discretion apply to the United States district court . . . within the jurisdiction of which the home office of the bank is located, for the enforcement of any effective and outstanding notice or order issued under this section, and such courts shall have jurisdiction and power to order and require compliance herewith; but except as otherwise provided in this section no court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under this section, or to review, modify, suspend, terminate, or set aside any such notice or order.

Under the Board's view, its decision not to institute cease and desist proceedings and its judgment that commercial paper is not a security under the Glass-Steagall Act are insulated from judicial scrutiny by these provisions. A decision not to adjudicate whether Bankers Trust's conduct was illegal is, in the Board's opinion, analogous to decisions by the Federal Trade Commission and the General Counsel of the National Labor Relations Board exercising their "prosecutorial discretion." *See Moog Industries, Inc.* v. *Federal Trade Commission*, 355 U.S. 411, 78 S. Ct. 377, 2 L. Ed. 2d 370 (1958); *Federal Trade Commission* v. *Klesner*, 280 U.S. 19, 46 S. Ct. 102, 70 L. Ed. 404 (1929) (both holding unreviewable a decision by the Federal Trade Commission not to institute cease and desist pro-

ceedings under section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45) and *National Labor Relations Board* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 138, 95 S. Ct. 1504, 1510, 44 L. Ed. 2d 29 (1975); *Vaca* v. *Sipes*, 386 U.S. 171, 182, 87 S. Ct. 903, 912, 17 L.Ed. 2d 842 (1967) (holding unreviewable a decision of the General Counsel of the Board not to issue an unfair labor practice complaint). The Board also finds shelter for this position in the language of the statute quoted above, in that an injunction directing the Board begin a proceeding to prevent Bankers Trust to sell third party commercial paper would, of necessity, "affect" the issuance of a cease and desist order and thus contravene 12 U.S.C. § 1818(i)(1).

The Board, however, ignores the procedural posture of the proceedings before it and before this Court. 12 U.S.C. § 1818(i) is a narrow statute, applying only to an "order issued under this section." Section 1818 establishes a detailed procedure to govern efforts by the Board to enforce against unsafe and unsound practices. None of these procedures were followed in this case. The Act provides for proper notice, a hearing, service of the Board's findings upon the bank under investigation, and review of the Board's decision in a court of appeals. In this action, Becker and SIA submitted materials to the General Counsel, who issued a legal opinion on the meaning of the Glass-Steagall Act as applied to Bankers Trust's conduct. The General Counsel, while soliciting materials from Bankers Trust, held no formal hearing but rather worked with his staff to reach a resolution of plaintiffs' expressed concerns. He gave the plaintiffs the oportunity to request that he seek review of his own decision by the Board of Governors. Plaintiffs then sought from the Board of Governors a review of the General Counsel's legal opinion and, in connection with that review, the institution of enforcement proceedings. The Board agreed with its General Counsel and decided not to institute an adjudication against Bankers Trust. At this stage, where the plaintiffs are challenging the legal conclusion reached by the General Counsel and adopted by the Board, § 1818 does not proscribe review.

This analysis finds support in *Groos National Bank* v. *Comptroller of the Currency*, 573 F.2d 889 (5th Cir. 1978). The appellate court held that jurisdiction did not vest in the district court to issue a declaratory judgment against the Comptroller, but explicitly found that "the Comptroller [had] set in motion cease and desist proceedings as authorized by 12 U.S.C. § 1818." *Id.* at 892. This is not an action such as *Groos* where "this regulatory process is not to be disturbed by untimely judicial intervention," *id.* at 895, because the administrative process here has reached a final conclusion that the Glass-Steagall Act is not violated when a state member bank sells commercial paper issued by unrelated corporations.

Moreover, it is a well recognized exception to statutes precluding judicial review that if an agency acts beyond the scope of its statutory authority, courts may exercise jurisdiction to overturn that administrative action. *See Manges* v. *Camp*, 474 F.2d 97 (5th Cir. 1973) (decision of Comptroller of the Currency outside of its authority is reviewable notwithstanding § 1818). *See also Leedom* v. *Kyne*, 358 U.S. 184, 79 S. Ct. 180, 3 L. Ed. 2d 210 (1958) (action within discretion of National Labor Relations Board General Counsel is reviewable if he exceeds statutory authority).

Section 1818 does, however, preclude the Court from granting plaintiffs' prayer that an injunction be issued ordering that cease and desist proceedings be commenced against Bankers Trust. *See* Becker Complaint at 11, ¶ 6; SIA Complaint at 8, ¶ 5. It is beyond the jurisdiction of this court, and probably any court, to order the Board, by injunction, writ of mandamus, or otherwise, to begin cease and desist proceedings against a bank. Such a directive would surely intrude upon the limitation set out in § 1818(i)(1), that "no court shall have jurisdiction to affect by injunction or otherwise the issuance . . . of any notice or order under this section . . . ." It is clear, therefore, that the Court's power to grant relief in this action is limited to reviewing the legal conclusion reached by the Board concerning the meaning of the Glass-Steagall Act, and to issuing whatever declaratory order may be appropriate.

As a second and independent ground for its argument that the Court lacks jurisdiction, the Board maintains that its decision that Bankers Trust is not violating the Glass-Steagall Act is wholly within its discretion and therefore unreviewable. The Administrative Procedure Act deprives courts of jurisdiction where "agency action is committed to agency discretion by law." 5 U.S.C. § 701(a)(2). The Supreme Court of the United States has interpreted this withdrawal of jurisdiction as predicated on a showing that nonreviewability must "fairly be inferred," from the regulatory framework, *Barlow* v. *Collins*, 397 U.S. 159, 166, 90 S. Ct. 832, 837, 25 L. Ed. 2d 192 (1970), and that the statutes are drawn such that "there is no law to apply." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 410, 91 S. Ct. 814, 820, 28 L. Ed. 2d 136 (1971).

Whether a statute is drawn so broadly that there is no law to apply "turns on pragmatic considerations as to whether an agency determination is the proper subject of judicial review." *Natural Resources Defense Council* v. *Securities and Exchange Commission*, 606 F.2d 1031, 1043 (D.C. Cir. 1979). In that decision, the Court of Appeals set out the proper focus of the inquiry:

> . . . we first identify as precisely as possible the aspects of the agency's action against which the challenge is brought. We then evaluate the relevance of three particularly important factors: the need for judicial supervision to safeguard the interests of the plaintiffs; the impact of review on the effectiveness of the agency in carrying out its congressionally assigned role; and the appropriateness of the issues raised for judicial review. Finally, we inquire whether the considerations in favor of nonreviewability thus identified are sufficiently compelling to rebut the strong presumption of judicial review.

Id. at 1044 (citations omitted).

The exact agency action under attack in this case is the Board's ruling that the Glass-Steagall Act is not violated when a state member bank sells third party commercial paper. The Board attempts to characterize its decision as based on more

than a purely legal analysis, but this is just not the case. Although the Board solicited materials from Bankers Trust on its activities, it chose expressly not to rely on this factual material. In the Board's statement it concluded,

> Since, in the Board's opinion, the stronger argument is that commercial paper should not be treated as a security covered by the Glass-Steagall Act, the restrictions of the Act with regard to issuing, underwriting, selling, and dealing in securities do not apply. Thus, it is not necessary to reach the issue of whether the activities engaged in by Bankers Trust are prohibited by the Act.

R. At 688. Notwithstanding the Board's reliance on its special knowledge of the commercial paper market, once it decided not to address any factual matters underlying Bankers Trust's activity, it transformed the proceeding into a purely legal inquiry. Thus, the background of this dispute is materially different from that faced in *New York Stock Exchange* v. *Bloom*, 562 F.2d 736 (D.C.Cir. 1977), *cert. denied* 435 U.S. 942, 98 S.Ct. 1520, 55 L.Ed.2d 538 (1978), where the Court of Appeals decided to dismiss as unfit for review a petition seeking reversal of a decision of the Comptroller of the Currency that a specific automatic stock-investment plan did not violate the Glass-Steagall Act. In that case, the Court expressly noted that the Comptroller had assessed factual matters beyond a mere interpretation of the Act. But the Court was explicit as to how a pure legal question would be presented: "No doubt determining the general interest of Congress from the language and history of the Act is a matter of law. . . ." *Id.* at 741. A perusal of the Board's statements associated with its decision reveals that the Board resolved just a legal question in response to the Becker and SIA petitions. A weighing of the factors then set out in *Natural Resources Defense Council*, *supra*, leaves little doubt that the question presented is not only appropriate for review, but also demands judicial oversight in order to render a proper statutory interpretation.

Although the Board had discretion to make its legal decision, that discretion is neither absolute nor unreviewable. Rather, it represents the sort of administrative adjudication that has been held reviewable in the federal courts for "legal error, procedural defect or abuse." L. Jaffe, *Judicial Control of Administrative Action 362-63 (1965). See Nader* v. *Saxbe*, 497 F.2d 676, 679-80 n. 19 (D.C.Cir. 1974). In *Natural Resources Defense Council*, it was noted that the Administrative Procedure Act itself "command[s] an exacting judicial scrutiny" of agency determinations of "pure questions of law." 606 F.2d at 1048. *See* 5 U.S.C. §§ 706(2)(B),(C),(D). It is difficult to imagine an issue more suited to judicial review than the Board's determination; indeed, the Board's contentions on the merits of this litigation are predicated almost wholly on canons of statutory interpretation and an analysis of legislative history, which belie its claim that there is no law to apply. Moreover, the Board made no showing that review in this case would hamper its effectiveness in the future. It merely maintained that courts should not direct that a specific enforcement tool be chosen, and that the statute's lack of guidance as to when a cease and desist order is appropriate should be respected. Although it is true that § 1818 offers scant direction governing when the Board should institute cease and desist proceedings, whether the Board's legal conclusion is proper rests on inquiries familiar to all courts.

Further, the Board's suggestion that nonreviewability can fairly be inferred from the statutory framework is flawed. Defendants contend that § 1818(b)(1) suggests that courts should not interfere in actions such as this. That section provides that "[i]f in the opinion of the appropriate . . . agency, any insured bank" has violated the law or engaged in an unsafe practice, "the agency may issue" a notice of charges to initiate enforcement proceedings." This section neither expressly nor impliedly affects the review of purely legal determinations. It merely leaves the Board with discretion to decide when to initiate enforcement proceedings. The Board's characterization of its discretion sweeps too broadly, because it attempts to apply this narrowly drawn enactment to insulate

from review any ruling on a wholly legal issue as long as the decision is somehow related to the institution of enforcement actions.[6]

The parties' positions as to the exact nature of the Board's action are not entirely illuminating because, in one sense, they are all only partially accurate. The plaintiffs assert (and it would be difficult to contravene), that the Board issued a ruling on a question of law, *i.e.*, that state member banks, under the Glass-Steagall Act, could permissibly sell third party commercial paper. The Board correctly notes, though, that this decision was pronounced in the context of deciding whether to initiate cease and desist proceedings against Bankers Trust. Neither the judicial nor the administative processes provide for decisions on legal questions in a vacuum; each dispute is occasioned by factual developments that give rise to a particular problem. The difficulty courts face is in effectuating the delicate balance between the smooth exercise of administrative discretion in areas where agencies have expertise and the right of a party aggrieved with an administrative agency's interpretation of a legal question to seek judicial review.

The statutory scheme created in § 1818 precludes judicial interference in the enforcement processes until the appropriate stage, but nothing in § 1818, nor even in traditional canons of administrative law, prevents this Court from reviewing the propriety and correctness of the Board's legal determination that state member banks may sell third party commercial paper.[7] To hold that jurisdiction is absent here would be to vest

6 The parties briefed and argued the question whether the Board's decision was ripe for resolution in this Court because, at the time the motions were filed, the Board had not issued the promised guidelines to guard against what it thought to be potential unsafe practices resulting from a state member bank's sale of third party commercial paper. When these guidelines were issued, however, *see n.* 3, *supra* [197A], this issue evaporated from this controversy and hence will not be addressed.

7 This decision by the Board will undoubtedly have far reaching effect, much broader than merely permitting Bankers Trust to continue its commercial paper activity. The Board itself, as it issued guidelines

the Board with unreviewable discretion in any proceeding, limited only to facts presented, to resolve broad legal questions that are particularly within the competence of the courts to decide. Since the Court may not intrude into the congressionally sanctioned enforcement procedures set out in § 1818, and cannot therefore enjoin the Board to institute cease and desist proceedings, the Court's authority is restricted to resolution of the legal question presented and the grant of equitable relief consonant with that decision, within the bounds of appropriate judicial review.[8]

Before proceeding to consider the substance of the Board's conclusion, the parties vociferously dispute the degree of deference to be given the Board's expertise in the regulation of commercial banking in the United States. The Board suggests that its decision is immune from judicial alteration unless arbitrary, capricious, or wholly irrational. Plaintiffs contest this claim, pointing out that they challenge the Board's ruling on a legal question, reversal of which is mandated by the Administrative Procedure Act if not in accordance with the statute. 5 U.S.C. § 706.

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for all banks to follow, recognized that many banks were likely to adopt the route of Bankers Trust.

8 Although not raised by the parties, one final point on the jurisdictional issue warrants mention. In *Becker I*, the Court found that the Board's closure of its meetings on the petitions of *Becker* and *SIA* satisfied exemption 10 of the Sunshine Act, 5 U.S.C. § 552b(c)(10), which permits an agency to refuse to open a meeting concerning a decision to participate in adjudicatory proceedings, because the possibility of cease and desist proceedings was raised and discussed. That finding does not foreclose the determination that the matter on review at this time is the legal determination reached by the Board in conjunction with its decision not to initiate an action against Bankers Trust. The part of the Board's decision which rejected any enforcement proceeding against Bankers Trust is not subject to review, and to the extent that it was likely that proceedings against Bankers Trust might be discussed at the meetings, the Court remains convinced that the meetings were properly closed. That cease and desist proceedings may have been mentioned, however, does not assault the Court's authority to review the Board's resolution of the legal question at issue herein.

Amidst these opposing contentions the Court of Appeals has recently reaffirmed the Court's delicate role in deciding cases such as these:

> We are fully aware of the deference due the construction placed on a statute by an agency charged with the responsibility for administering it. . . . However, to accord deference is not to abdicate our duty to construe the statute, for the "courts are the final authorities and 'are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "

National Association of Recycling Industries, Inc. v. *Interstate Commerce Commission*, 660 F.2d 795 at 798-99 (D.C.Cir., 1981). Specifically with regard to federal banking legislation, the Supreme Court has recognized the expertise of the Board in interpreting and administering that statute. *See Board of Governors* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947). Nonetheless, the duty to examine the Board's rule to ensure its accordance with the law cannot be shirked. In *National Distributing Co.* v. *United States Treasury Department*, 626 F.2d 997 (D.C.Cir. 1980), the Court noted,

> This Court is vested by statute with the authority and responsibility to "decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action.". . . We are required to "hold unlawful and set aside agency action, findings, and conclusions found to be . . . not in accordance with the law[.]"

Id. at 1019, *quoting* the Administrative Procedure Act, 5 U.S.C. § 706.

Some illumination of the statutory framework surrounding this litigation is appropriate. The Glass-Steagall Act was part of a package of banking reforms passed during the early part of the Presidency of Franklin Delano Roosevelt. Two of its sections are pertinent to this dispute:

Section 16 (12 U.S.C. § 24) Corporate Powers of Associations

Seventh. . . . The Business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the *association shall not underwrite any issue of securities or stock: Provided,* That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. . . . As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association or corporation in the forms of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may be prescribed by the Comptroller of the Currency.

* * * * * * * *

Section 21 (12 U.S.C. § 378) Dealers in securities engaging in banking business; individuals or associations engaging in banking business; examinations and reports; penalties.

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, *engaged in the business of issuing, underwriting, selling or distributing*, at wholesale or retail, or through syndicate participation, *stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits* subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt. . . . (Emphasis added).

These provisions are made applicable to state member banks by 12 U.S.C. § 355.

The plaintiffs contend that the Board's decision contravenes the plain meaning of the Glass-Steagall Act because Bankers Trust, an institution in the business of receiving deposits, is, in their view, selling or underwriting commercial paper, which the plaintiffs argue is a security.

The first question to be addressed, then, is whether commercial paper is in fact a "note or other security" for purposes of the Glass-Steagall Act. In its statement asserting several legal bases for accepting the General Counsel's opinion, and in this litigation, the Board has attempted to justify its decision that commercial paper was not included in the Glass-Steagall Act. Section 21, the Board argues, was not intended to prohibit traditional banking functions, and the sale by Bankers Trust of third party commercial paper resembles other banking functions such as the sale of notes and bankers' acceptances to other lenders and the issuance of certificates of deposits. A decision that commercial paper is included within the Act's prohibition would, the Board suggests, jeopardize a host of traditional banking functions. Additionally, the Board analyzed the transaction involved in the sale of third party commercial paper and concluded that such activity resembled a loan, not a sale of securities. Although Congress did not, in 1933, specifically allude to commercial paper in the proceedings over Glass-Steagall, the Board points to indirect evidence that commercial paper was not intended to be included in the definition of "notes or other securities."

Plaintiffs maintain that the plain meaning of the Glass-Steagall Act prohibits exactly what Bankers Trust is doing, mixing the business of banking with the commerce of dealing in securities. The plaintiffs characterize the defendant's "parade of horribles" as irrelevant, because the traditional activities referred to by the Board are specifically permitted by other sections of the banking laws. In the plaintiffs' view what distinguishes Bankers Trust's conduct from other, more traditional banking functions, is the unique role of Bankers Trust, functioning between the issuer and the purchaser of commer-

cial paper. That role, the plaintiffs contend, is precisely what Congress intended to eliminate by its strict separation of investment banking from normal depository banking. Further, plaintiffs reject the Board's "functional anaylsis" that commercial paper is much like a loan, contending that the Board ignored the role of the bank in examining the transaction between the issuer of commercial paper and the purchaser. The plaintiffs also focus on the legislative history of the Glass-Steagall Act to support their position, citing, too, the Securities Act of 1933, which defines "securities" explicitly to include commercial paper. The Congress, plaintiffs proclaim, plainly sought to separate all dealing in speculative and other investments from the normal, more stable business of banking.

All statutory analysis begins with the recognition of an essential truth: "In any case concerning the interpretation of the statute, the 'starting point' must be the language of the statute itself, *Lewis* v. *United States*, 445 U.S. 55 [100 S.Ct. 915, 63 L.Ed.2d 198] (1980). . . ." *National Association of Recycling Industries, Inc.* v. *Interstate Commerce Commission*, 660 F.2d 795 at 799 (D.C.Cir. 1981). *See also Aaron* v. *Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980). Also entrenched in statutory interpretation is the principle that where a statute is not ambiguous, the party attempting to avoid its plain language must offer "persuasive reasons" for concluding that Congress did not mean what it said. *Higgins* v. *Marshall*, 584 F.2d 1035, 1037 (D.C.Cir. 1978), *cert. denied*, 441 U.S. 931, 99 S.Ct. 2051, 60 L.Ed.2d 659 (1979). *See Tennessee Valley Authority* v. *Hill*, 437 U.S. 153, 98 S.Ct. 2279, 57 L.Ed. 117 (1978). The plain meaning of a statute may be avoided where there has been a significant change of circumstances since enactment or when a literal reading leads to an unreasonable or absurd result. *Consumers Union of the United States, Inc.* v. *Heimann*, 589 F.2d 531, 534 (D.C.Cir. 1978).

What does a "plain" reading of the Glass-Steagall Act then reveal? Defendants cannot and do not seriously dispute that commercial paper is a "note or other security" as mentioned in Section 21. The parties agree that commercial paper consists of

short-term, negotiable, usually prime quality and unsecured notes. That under a strict reading of the Act, commercial paper would be covered by Section 21 is bolstered by the Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed. 2d 367 (1971) (hereinafter *ICI I* or *Camp*) that "[t]here is nothing in the phrasing of either § 16 or § 21 that suggests the narrow reading of the word 'securities.' To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt." *Id.* at 635, 91 S.Ct. at 1101. Indeed, the statutes' unambiguous reference to "notes and *other* securities" surely indicates Congress's interpretation that the term "securities" encompassed "stocks, bonds, debentures and notes" in section 21. This meaning ascribed to section 21 applies with equal force to section 16, which does not mention "notes," but refers rather to "securities or stocks." *See Fortin* v. *Marshall*, 608 F.2d 525, 528 (1st Cir. 1979) (giving same words identical meanings in a single statute).

Does this strict interpretation of the Glass-Steagall Act lead to absurd and outrageous results? In the Board's view, many traditional commercial banking functions would simply grind to a halt were this Court to rule for plaintiffs, but their fears appear greatly exaggerated. Section 16 of the Glass-Steagall Act clearly recognizes that banks may discount and negotiate promissory notes as part of their traditional lending functions. Moreover, this Court is not presented with a broad-scale attempt by plaintiffs to reorganize the entire commercial banking industry. Rather, holding commercial paper to be included in the prohibition of the Glass-Steagall Act yields no great damage to the foundation of commercial banking. Whatever the Board decides to undertake as a result of the declaration herein is neither predicted nor directed, but when it recognizes that third-party commercial paper is a "note or other security," its mandate under the law will have been fulfilled.[9]

9 The Board decided that commercial paper was not an investment security and then swept to the conclusion that if the Court held that commercial paper was a note or security, banks would be completely

Reliance on the literal language of sections 16 and 21 is supported by the 1971 decision in *ICI I*. In *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 101 S.Ct. 973, 67 L.Ed.2d 36 (1981) (hereinafter "*ICI II*") Mr. Justice Stevens described the *Camp* decision:

> In *Camp* the Court *relied squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act*. After noting that § 16 prohibited the underwriting by a national bank of any issue of securities and the purchase for its own account of shares of stock of any corporation, and that § 21 prohibited corporations from both receiving deposits and engaging in issuing, underwriting, selling, or distributing securities, *the Court recognized that the statutory language plainly applied* to a bank's sale of redeemable and transferable "units of participation" in a common investment fund operated by the bank.

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precluded from purchasing commercial paper. This, the Board contends, is an absurd result justifying rejection of the plain statutory language. The Board's contention that commercial paper is not an investment security, however, is not persuasive.

Section 16 grants to the Comptroller of the Currency the discretion to classify some securities as investment securities to permit banks to purchase them for their own account. The Comptroller's regulations specify that an investment security is "a marketable obligation in the form of a bond, note, or debenture which is commonly regarded as an investment security" that is not "predominately speculative in nature." 12 C.F.R. § 1.3(b). The Bank points to the legislative history of the McFadden Act of 1927 where Congressman McFadden clearly states that commercial paper was not considered an investment security. *See* 67 Cong. Rec. 3232 (1926). Plaintiffs indicate, however, that the McFadden Act was eviscerated by the Glass-Steagall Act in that Congress rejected the notion that commercial banks could be engaged in the investment banking business, a premise recognized by the McFadden Act. Additionally, plaintiffs submitted a letter from the Chief National Bank Examiner, dated March 10, 1981, in a matter unrelated to this dispute, where it is held that what is a loan for one purpose may be a security for another. Becker Reply Mem., Exh. 3. Banks could, even in light of the Court's holding, continue to purchase commercial paper as they traditionally have, and plaintiffs' arguments do not appear inconsistent with the scheme of the Glass-Steagall Act.

Id., 101 S.Ct. at 986 (emphasis added). See generally Clark and Saunders, *Judicial Interpretation of Glass Steagall: The Need for Legislative Action*, 97 Banking L.J. 721 (1980) (noting that courts traditionally invoke a literal interpretation of the Glass-Steagall Act).

The broad framework of the Glass-Steagall Act demonstrates that Congress intended to pass a flat prohibition against any single type of institution—commercial or investment banking—from engaging in any of the badges incident to the others' enterprise. The statute draws broad lines, leaving no room for administrative amendment. It reflects "the unalterable and emphatic intention of Congress to divorce commercial banks from the business of underwriting and dealing in securities." *Baker, Watts & Co.* v. *Saxon*, 261 F.Supp. 247, 252 (D.D.C. 1966), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968). Deemed a "drastic step," the Glass-Steagall Act prohibits "commercial banks, banks that receive deposits subject to repayment, lend money, discount and negotiate promissory notes and the like, from going into the investment banking business." *ICI I*, 401 U.S. at 629, 91 S.Ct. at 1098. The Act "was a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *Id.* at 639, 91 S.Ct. at 1103. The Court in *ICI I* further applied "as they were written" the Act's "literal terms" to overturn a decision of the Comptroller of the Currency to permit commercial banks to operate investment funds. *Id.*

This reading of the Glass-Steagall Act's framework is different from the Bank Holding Company Act of 1956, analyzed by the Supreme Court in *ICI II*. That statute authorizes the Board to determine whether a given activity is sufficiently related to banking to permit a nonbanking subsidiary of a bank holding company to engage therein. *See ICI II*, 450 U.S. at 73, 101 S.Ct. at 990. The Bank Holding Company Act clearly provides for the sort of discretionary decision made by the Board in this dispute, as it might be applied to a subsidiary of a bank holding company. But nowhere in the Glass-Steagall Act is the Board authorized, despite the plain language of the

statute, to permit a bank to engage in a particular activity because it does not pose risks to consumers or investors. Indeed, as the Court in *ICI I* recognized,

> From the perspective of competition, convenience, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards [of that choice] made necessary to prohibit this activity to commercial banks.

ICI I, 401 U.S. at 636, 91 S.Ct. at 1101. Indeed, with the exception of the delegation in Comptroller of the Currency to determine what is an "investment security," there are no lines to be drawn.

The parties delve into the legislative history of the Glass-Steagall Act, neither producing convincing evidence of how Congress might have answered the question posed by this case were it presented in 1933. Nowhere in the record of the Act do the drafters define whether commercial paper is a note or other security. The defendants suggest that the Congress recognized that transactions in commercial paper were part of traditional banking practices at the time the Act was passed, and not part of the speculative business that gave rise to the prohibitions contained in the Act. Indeed, Senator Glass, whose name the Act bears, proposed during a debate on the Securities Act of 1933 that short term notes, including "nine months' commercial paper," be excluded from the definition of security contained in that legislation because such a definition would "radically interfere" with "ordinary commercial banking transactions." *Securities Act: Hearings on S. 875 before the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). Plaintiffs counter that although banks were traditionally large purchasers of commercial paper, their role as seller was limited to occasional transactions; indeed, Congress's rejection of Senator Glass's proposal demonstrates a view that commercial paper was considered a security. It is unnecessary to trace the historical development of the commercial paper market; rather, based on the undisputed facts, the

role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions. Congress's silence as to commercial paper specifically, combined with the general scheme of the Act, indicates that it did not contemplate adjustments in the definition of "notes or other securities" by the Board or any other agency in an administrative proceeding.

The parties energetically dispute whether the definition of security in the Securities Act of 1933, which includes "any note," 15 U.S.C. § 77b(1), affects the interpretation of the Glass-Steagall Act. Although short term notes such as commercial paper are exempt from the registration provisions of the Securities Act of 1933, the antifraud proscriptions still apply. *See* 15 U.S.C. §§ 77c(a)(3), 77l(2). Defendants contend that the statutes have such different general purposes that it would be unreasonable to impute the definition of security offered in one statute to another act. *United Shoe Workers of America* v. *Bedell*, 506 F.2d 174, 188 (D.C.Cir.1974). Although the Securities Act of 1933 and the Glass-Steagall Act take regulatory aim at different financial institutions and markets, they were passed within three weeks of each other and designed to remedy the then existing catastrophe in the nation's financial markets. This is surely compelling evidence that the two statutes should be interpreted similarly. The district court, eventually affirmed in *ICI I* declared, "It would be inconsistent to conclude that Congress did not intend to obtain the equivalent meaning for the term 'securities' as used in the Securities Act of 1933 when it used the same term in the Glass-Steagall Act which was enacted by the same Congress." *Investment Company Institute* v. *Camp*, 274 F.Supp. 624, 642-43 (D.D.C.1967) (footnote omitted), *rev'd* 420 F.2d 83 (D.C.Cir. 1969), *rev'd* 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971).

In an analogous decision, *United States* v. *American Building Maintenance Industries*, 422 U.S. 271, 95 S.Ct. 2150, 45 L.Ed.2d 177 (1975), the Supreme Court considered the phrase "in commerce" as it is used in the Federal Trade Commission Act and in the Clayton Act, and concluded that "since both sections were enacted by the 63d Congress, and both were

designed to deal with closely related aspects of the same problem—the protection of free and fair competition in the Nation's marketplaces," the statutes should be given similar interpretations. *Id.* at 277, 95 S.Ct. at 2155. Both the Glass-Steagall Act and the Securities Act were directed at curing the perceived rampant speculation by banks, securities dealers, and individuals prior to the Crash of 1929, such activity considered the chief cause of the Great Depression; their common goals suggest the relevance of the similar definitions.

The Board's final justification for its interpretation of the Glass-Steagall Act is its "functional analysis" of a commercial paper transaction which, in its view, compels the conclusion that commercial paper is more like a loan transaction than a security sale. The Board found that commercial paper, as short-term notes, functioned to provide corporations with cash and that banks, as traditional purchasers of commercial paper, effectively loaned such money to the issuers. *See* R. 682-84. The problem with the Board's analysis emerges instantaneously: it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account, *e.g.*, its trust department, or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. The Board's analysis would also sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks. The dispute over the Board's determination that commercial paper represents a loan reveals the problematic query presented in this challenge: when is a device to raise funds for a business a loan and when is it a security? One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and that crucial aspect is the role of Bankers Trust in the transactions.[10]

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10 The Court, like the Board, does not reach the question whether Bankers Trust was actually underwriting securities in violation of the Glass-Steagall Act. The question presented herein is whether the Board

This dispute is only the proverbial tip of the iceberg as to debates currently raging in the houses of Congress concerning the proper functions of commercial banks, especially in light of a more active "banking" role taken by securities' dealers. In its *amicus* memoranda, the Securities and Exchange Commission argues forcefully and persuasively that any alteration of the lines drawn by current banking statutes is for the popularly-elected Congress to undertake. Especially in light of these current efforts to reallocate the roles of depository and non-depository institutions, both the Court and the Board should refrain from unique and heretofore unprecedented interpretations of the 1933 Glass-Steagall Act which cast such a long shadow as does the Board's ruling on the Becker and SIA petitions. The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.[11]

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erred when it concluded that commercial paper was not a security under the Act. Although the Court has offered various characterizations to Bankers Trust's conduct, by no means does this opinion mean to convey that the bank was underwriting securities.

11 Becker contends that it was denied procedural due process by the Board in that the Board denied its request for a hearing or oral argument and refused to provide advance notice to Becker of the Board's meetings. The Court, in *Becker I* has already ruled on the open meeting aspect of the litigation, and Becker had no absolute right to present an oral argument. All of the written materials submitted were sufficient to permit the Board to deny oral argument without abusing its discretion. *Arthur Lipper Corp. v. Securities and Exchange Commission*, 547 F.2d 171, 182 n.8 (2d Cir. 1976), *cert denied*, 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). Becker also argues that the Board received *ex parte* communications from Bankers Trust while it was deliberating on the Becker and SIA petitions. The Board proffers an affidavit of Rose L. Arnold, in charge of the Freedom of Information Office for the Board, who indicates that the material received from Bankers Trust was available for inspection in the public reading room of the Board. Its availability to Becker and to the public negates Becker's contention that this material (now a part of the administrative record, *see* R. at 476-550) was concealed or that the Board's receipt of such documents prejudiced Becker's rights.

A word need be added about the exact nature of the relief to be awarded plaintiffs. As previously noted, the law prohibits any court from affecting the issuance of a cease and desist order under 12 U.S.C. § 1818. The plaintiffs have indicated that the principal relief sought is a declaratory judgment that the Board's September 26, 1980 ruling that commercial paper is not a note or security under the Glass-Steagall Act is contrary to law. Such a judgment is within the province of this Court to award, and is attached herein. The Court expresses no opinion as to what steps, if any, may be taken following the issuance of this declaratory judgment.

Opinion of the United States Court of Appeals for the District of Columbia Circuit

UNITED STATES COURT OF APPEALS
DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-2070, 81-1493, 81-2058,
81-2096 and 80-2314

Argued 3 June 1982
Decided 2 Nov. 1982
As Amended Nov. 2, 1982

A.G. BECKER INCORPORATED,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

SECURITIES INDUSTRY ASSOCIATION,
Petitioner-Appellee,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,
Respondents-Appellants.

APPEARANCES:

Richard M. Ashton, Washington, D.C., with whom Michael Bradfield, Washington, D.C., was on the brief for Bd. of Governors of the Federal Reserve System, et al., appellants Nos. 81-2058 and 81-2070 and appellants/respondents in Nos. 80-2258, 80-2314, 81-1493 and 81-2096, James V. Mattingly, Jr., Washington, D.C., also entered an appearance for the Bd. of Governors of the Federal Reserve System, et al.

James B. Weidner, New York City, with whom John M. Liftin, Washington, D.C., was on the brief for Securities Industry Ass'n., petitioner in No. 80-2314 and appellee in No. 81-2058. Janet R. Zimmer, Washington, D.C., also entered an appearance for Securities Industry Ass'n.

Harvey L. Pitt, Washington, D.C., with whom Henry A. Hubschman and Andrea Newmark, Washington, D.C., were on the brief for A.G. Becker Inc., petitioner in No. 80-2258, appellants in Nos. 81-2096 and 81-1493 and appellee/respondent in No. 80-2070. James H. Schropp, Washington, D.C., also entered an appearance for A.G. Becker Incorporated.

Robert S. Rifkind, New York City, entered an appearance for New York Clearing House Ass'n, amicus curiae in Nos. 81-1493, 81-2258 and 81-2096.

Charles F.C. Ruff, U.S. Atty., Royce C. Lamberth, Kenneth M. Raisler, William H. Briggs, Jr., Asst. U.S. Attys., Washington, D.C., also entered an appearance for appellee/respondent in No. 81-1493.

John W. Barnum and W. Michael Tupman, Washington, D.C., entered appearances for Bankers Trust Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Leonard H. Becker, Steven A. Musher and Joseph McLaughlin, Washington, D.C., entered appearances for Goldman, Sachs and Co., amicus curiae in Nos. 80-2314, 81-2058, 80-2258, 81-1493, 81-2096 and 81-2070.

Paul Gorson and Russell Stevenson, Washington, D.C., entered appearances for Securities and Exchange Com'n, amicus curiae in Nos. 81-2096 and 81-2058.

Before TAMM and WILKEY, Circuit Judges and ROBB, Senior Circuit Judge.

Opinion for the Court filed by Circuit Judge WILKEY.

Dissenting opinion filed by Senior Circuit Judge ROBB.

WILKEY, *Circuit Judge*:

This case calls upon us to decide whether the Federal Reserve Board acted lawfully in permitting the Bankers Trust Company, a state member bank of the Federal Reserve System,[1] to act as agent in the sale of commercial paper. After Bankers Trust began marketing commercial paper, A.G. Becker, Inc., a broker-dealer in securities, and the Securities Industry Association ("SIA"), an organization representing over five hundred securities brokers and dealers, requested the Board to declare Bankers Trust's activities illegal and to bring appropriate enforcement action. Becker and the SIA contended that Bankers Trust was in violation of sections 16 and 21 of the Glass-Steagall Act ("the Act"), which prohibit commercial banks, with certain exceptions, from buying, selling, or underwriting "securities."[2] The Federal Reserve Board determined, however, that the commercial paper marketed by Bankers Trust

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1 *See* 12 U.S.C. §§ 321-339 (1976 & Supp. IV 1980).

2 Section 16 of the Act provides in pertinent part:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24 Seventh (Supp. IV 1980).

Section 21 provides that:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1)(1976).

was not a "security" within the meaning of the Act.[3] Becker and the SIA then brought suit in the district court, which held the Board's determination to be invalid.[4] The Board appealed, and we reverse.

I. FACTS

"Commercial paper" refers to prime quality, negotiable promissory notes bearing very short maturities—generally 30 to 90 days.[5] Large, financially strong corporations use commercial paper to obtain funds for current needs. Commercial paper is sold, in denominations averaging one million dollars or more, to large, sophisticated purchasers—money market mutual funds, bank trust departments, insurance companies and pension funds.[6]

Bankers Trust began placing third party commercial paper in 1978.[7] Its issuers had the highest rating from at least one of the rating services for commercial paper issuers; its customers were part of the bank's established base of institutional investors, who regularly purchase short term instruments from the bank. The bank offered to act as financial adviser to issuers of paper sold by the bank, and to extend credit to them, though for only

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3 Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (26 Sept. 1980), Joint Appendix (J.A.) at 220 [hereinafter cited as Federal Reserve Statement].

4 *A.G. Becker, Inc.* v. *Board of Governors*, 519 F. Supp. 602 (D.D.C. 1981).

5 *See generally* Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts*, 39 U. Chi. L. Rev. 362 (1972).

6 *See* sources cited at *supra* note 5. *See also infra* p. 149 [245A].

7 This description of Bankers Trust's activities relies upon Federal Reserve Statement, *supra* note 3, at 2-3, J.A. at 221-22. Appellees do not challenge the Board's factual findings as to Bankers Trust's participation in the commercial paper market.

a small portion of the unsold amount of the issue. It did not commit itself to purchase unsold paper, but it did purchase in the secondary market commercial paper of issuers for which it had acted. Bankers Trust was the first commercial bank to enter the commercial paper market in competition with the investment banks; other commercial banks awaited the outcome of subsequent legal proceedings.

Becker and the SIA requested the staff of the Federal Reserve Board to review the legality of Bankers Trust's activities. The Board's general counsel, after extensive discussion with Becker, SIA, Bankers Trust and the SEC, issued an opinion declaring that commercial banks may lawfully act as agent for the issuer in the sale of commercial paper, "provided that the sales . . . are limited to purchasers to whom commercial banks normally sell participations in loans."[8] Becker and the SIA then requested the Federal Reserve Board to review the decision of its general counsel and to proscribe the commercial paper activities of member banks. After considering submissions by interested parties and conducting an on-site investigation of Bankers Trust's activities, the Board ruled that Bankers Trust's participation in the commercial paper market did not violate the Glass-Steagall Act or contravene public policy.[9]

In a carefully reasoned opinion the Board first concluded that there was no indication in the language or legislative history of the Glass-Steagall Act that Congress considered commercial paper to be a "security," in which banks were forbidden to deal.[10] The Board noted that banks had traditionally traded in commercial paper, and that the Act had been intended to strengthen banks in the exercise of traditional banking functions. The Board then turned to a "functional" analysis of the statutory terms, and concluded that, because

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8 Legal Division, Board of Governors of the Federal Reserve System, Commercial Paper Activities of Commercial Banks: A Legal Analysis 21 (28 June 1979), J.A. at 168.

9 Federal Reserve Statement, *supra* note 3.

10 *Id.* at 6-17, J.A. at 225-36.

commercial paper embodies short-term loans from a few sophisticated lenders to financially strong borrowers, it resembled a loan rather than a security for the purpose of the Glass-Steagall Act.[11] Because the Board ruled that commercial paper was not a "security," it did not reach the issue whether Bankers Trust was "issuing, underwriting, selling, or distributing" securities within the meaning of the Glass-Steagall Act.[12]

Subsequently, the Board issued guidelines to ensure that sale of third party commercial paper did not give rise to "unsafe or unsound practices."[13] These guidelines permitted banks to sell only prime quality third party commercial paper with maturity of nine months or less and in denominations of over $100,000. Banks could sell only to "financially sophisticated customers," and were forbidden to advertise to the general public. Sales to the bank's fiduciary accounts, parent holding companies and nonbank affiliates were also forbidden. Moreover, banks were required to maintain credit analyses of issuers, to limit the amount of paper sold for any issuer, and to maintain detailed records of sales, purchases and lines of credit extended. Finally, various disclosure requirements were imposed.

SIA and Becker sought review in the district court of the Board's ruling that commercial paper was not a "security." That court concluded that the Act's "plain language" barred commercial banks from trading in commercial paper.[14] It also found that the "broad framework" of the Act evinced Con-

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11 *Id.* at 17-20, J.A. at 236-39. The Board also rejected the arguments that the definition of "security" in the Securities Act of 1933, or considerations of public policy, militated against permitting Bankers Trust's sale of third party commercial paper. *Id.* at 20-27, J.A. at 239-46.

12 *Id.* at 24, J.A. at 243.

13 Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks, 46 Fed. Reg. 29333, 29334-35 (26 May 1981) [hereinafter cited as Guidelines].

14 *Becker,* 519 F. Supp. at 612-13.

gress' intent to institute a sweeping prohibition of commercial banks' engaging in investment banking activities.[15] Finally, in response to the Board's "functional" analysis of commercial paper, the court averred that "[o]ne factor . . . compels the conclusion that the commercial paper at issue here is [a security], and that crucial aspect is the role of Bankers Trust in the transaction."[16] For these reasons, the district court issued a declaratory judgment that the Board's ruling was contrary to law.[17]

We reverse. The district court gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act. Moreover, the language of the Act, its legislative history and the policies underlying it all support the Board's conclusions that commercial paper is not a "security" under the Act. We discuss each of these findings in turn.

II. STANDARD OF REVIEW

The Supreme Court recently had occasion again to delineate the standard to be applied in the review of an agency's interpretation of a statute which it is charged to implement.

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15 *Id.* at 614-15.

16 *Id.* at 615-16.

17 *Id.* at 616. The district court confined its holding to the question of whether the commercial paper at issue was a "security." Like the Board, it did not reach the question whether Bankers Trust was "underwriting" securities in violation of the Glass-Steagall Act. *See id.* at 616 n. 10.

Moreover, the district court did not explicitly rule on the validity of the Board's guidelines. However, because the guidelines in essence describe Bankers Trust's activities, it would be difficult to reconcile those guidelines with the district court's holdings. Conversely, if we find that Bankers Trust has acted lawfully, the activities of other commercial banks in compliance with the guidelines would be lawful as well. *See* Part IV (Conclusion) *infra*.

The task of the reviewing court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was '*sufficiently reasonable*' to be accepted by a reviewing court. . . . To satisfy this standard it is not necessary for a court to find that the agency's construction was the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[18]

In particular, the Board's ruling in the present case warrants deference for a number of reasons. First, the Board is "the type of agency to which deference should presumptively be afforded" because of *the scope of its authority.* Congress has vested the Board with "primary and substantial responsibility for administering" federal regulation of the national banking system.[19] The Board exercises "general supervisory" powers over member banks,[20] and is responsible to bring enforcement actions to prevent member banks from engaging in "unsafe or unsound" banking practices.[21] The Board thus formulates national banking policy, and, in implementing this policy, exercises broad rulemaking and adjudicative powers.

Second, deference to the Board's conclusions is warranted by its *expert knowledge of commercial banking*. "Not only because Congress has committed the [Federal Reserve] [S]ystem's operation to [the Board's] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, . . . their judgment should be conclusive upon any

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18 *Fed. Election Comm'n* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 39, 102 S.Ct. 38, 46, 70 L.Ed.2d 23 (1981) (emphasis added) (citations omitted).

19 *Compare Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46.

20 *See* 12 U.S.C. § 248 (1976).

21 *See* 12 U.S.C. § 1818(b) (Supp. IV 1980). *See also* 12 U.S.C. § 501a (1976) (enforcement actions for violation of banking laws and regulations).

matter which . . . is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have . . . in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer [the system]."[22]

Third, deference to an agency's construction of the statute is called for because *the agency's decision applies general, undefined statutory terms*—"notes and securities"—to particular facts. While the Glass-Steagall Act contains a sweeping prohibition of commercial banks' trading in "securities," that term is, of course, not self-defining.[23] Moreover, we cannot assume that Congress intended the term to comprise a set of rigid and unchanging categories. Rather, such statutory drafting "leave[s] the agency with the task of evolving definitions on a case-by-case basis."[24] The regulatory structure of the banking laws must be permitted to adapt to the changing financial needs of our economy.[25] Congress has delegated to the Federal Reserve Board, rather than to this court, the complex task of applying the Act's general proscriptions to current business reality. We must therefore defer to the Board's interpretation of the statute if that interpretation is reasonable.

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22 *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450, 67 S.Ct. 411, 415, 91 L.Ed. 408 (1947) (Rutledge, J. concurring). *See Board of Governors of Federal Reserve System* v. *Investment Co. Inst.*, 450 U.S. 46, 56 n.21, 101 S.Ct. 973, 981 n.21, 67 L.Ed.2d 36 (1981) (citing *Agnew*) [hereinafter cited as *ICI II*].

23 *See infra* p. 143 [232A-235A].

24 *Puerto Rico* v. *Blumenthal*, 642 F.2d 622, 635 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 983, 101 S.Ct. 2315, 68 L.Ed.2d 840 (1981); *Chisholm* v. *FCC*, 538 F.2d 349, 358 (D.C. Cir.), *cert. denied*, 429 U.S. 890, 97 S.Ct. 247, 50 L.Ed.2d 173 (1976).

25 *Cf. M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956, 98 S.Ct. 3069, 57 L.Ed.2d 1121 (1978) (bank laws construed to permit "use of new ways of conducting the very old business of banking"). The current situation of the commercial paper market could not have been foreseen by Congress at the time the Glass-Steagall Act was passed: that market has changed drastically since the Depression. *See infra* note 85.

Finally, "*the thoroughness evident in the consideration* [of an agency's interpretation of a statute], *the validity of its reasoning*, [and] *its consistency with earlier and later pronouncements*" are factors that bear upon the amount of deference to be given to an agency's ruling.[26] In this instance, the agency's interpretation of the statute is based on a thorough and expert review of the relevant legal and policy considerations as well as of the facts of this case. The Board conducted an extensive inquiry into the operation of Bankers Trust commercial paper operations and the function of the commercial paper market; it clearly set forth its findings, conclusions, and bases for its reasoning.[27] And the Board's conclusion is consistent with prior decisions, including some roughly contemporaneous with the passage of the Glass-Steagall Act.[28]

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26 *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 164, 89 L.Ed. 124 (1944) (emphasis added). *See Democratic Senatorial Campaign Comm.*, 454 U.S. at 39, 102 S.Ct. at 46 (citing *Swift*); *Adamo Wrecking Co.* v. *United States*, 434 U.S. 275, 287 n.5, 98 S.Ct. 566, 574 n.5, 54 L.Ed.2d 538 (1978) (same).

27 Federal Reserve Statement, *supra* note 3.

28 For example, in 1933 the Board stated that commercial paper, defined as short-term paper issued for obtaining funds for current transactions and purchased by banks and corporations with temporarily idle funds, should not be considered an investment security. *See Federal Securities Act: Hearing on H.R. 4314 before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180-81 (1933); *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933); Federal Reserve Statement, *supra* note 3, at 11, J.A. at 230.

The assumption that commercial paper is a loan rather than a security pervades current banking regulation. The Board has ruled that issuance of commercial paper by a bank holding company does not fall within section 20 of the Glass-Steagall Act, the analogous provision for those companies. *See* 12 C.F.R. § 250.221(e)(1982). Under the rules of the Comptroller General's office, commercial paper holdings by banks are subject to the statutory limits on loans rather than investment securities. *See* 12 C.F.R. § 7.1180 (1982) (interpreting 12 U.S.C. § 84 (1976)); Federal Reserve Statement, *supra* note 3, at 11-12, J.A. at

For these reasons, which we have considered in prior opinions and which may frequently be found of use in evaluating administrative agency decisions, we should hesitate to overturn the Board's decision as long as that decision is a reasonable interpretation of the Glass-Steagall Act. And, as will appear below, the decision was reasonable. We do not, however, rest merely on the deference to the conclusions of the Federal Reserve Board. "[T]o accord deference is not to abdicate our duty to construe the statute, for 'the courts are the final authorities and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' "[29] We therefore turn to an analysis of the application of the Glass-Steagall Act to the present case.

III. APPLICATION OF THE GLASS-STEAGALL ACT

Taking account of appropriate deference to the Board's expertise and administrative responsibility, we find that its ruling and the reasoning which supports it are essentially correct. An inquiry into the language and legislative history of the statute, and the policies underlying it, supports the Board's conclusion that the commercial paper marketed by Bankers Trust is not a "security" within the Glass-Steagall Act.

A. *Background*

Congress passed the Glass-Steagall Act in 1933, in response to what it perceived to be the abuses which resulted from the involvement of commercial banks in securities underwriting. Congress considered that commercial banks, by underwriting

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230-31. And commercial paper is treated as a loan for bank call reports and bank examination by the Federal Reserve Board. *Id.*

29 *Nat'l Ass'n of Recycling Inds., Inc.* v. *ICC*, 660 F.2d 795, 799 (D.C.Cir. 1981) (citations omitted).

stocks, had fueled the rampant speculation that preceded the Great Depression. Congress' principal concern in amending the banking laws, however, was to protect the solvency and integrity of the banks themselves.[30]

Stock underwriting by commercial banks undermined bank solvency in a number of ways. Most directly, commercial banks that engaged in underwriting tied up depositors' funds in the purchase of unsound or speculative securities. These investments placed commercial deposits at risk.[31] The promotional pressures exerted by underwriting activities also threatened bank solvency. To augment their commissions from securities sales, commercial banks used their credit facilities to lend to purchasers of securities.[32] Banks were also tempted to make unsound loans to client-issuers, because these loans might improve the balance sheet of these enterprises and thereby make their securities more marketable. When speculative ventures failed, these loans to purchasers and issuers were often not repaid, undermining bank solvency and depositor confidence in the banks.[33]

In addition to inducing commercial banks to purchase unsound securities and to make unsound loans, banks' participation in the securities market had more indirect effects on bank solvency. Banks' association with speculative securities ventures undermine the confidence of bank depositors in the stability of the banks.[34] Moreover, banks which underwrote

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30 *Senate Comm. on Banking and Currency, Operation of the National and Federal Reserve Banking Systems*, S. Rep. No. 77, 73d Cong., 1st Sess. 2-4, 6-13 (1933).

31 *Id.* at 9-10.

32 *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S.Res. 71 before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess. 87 (1931) (remarks of Chairman Glass) [hereinafter cited as *Hearings*].

33 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley).

34 *Id.*

stock issues could not be relied upon to give prudent and disinterested investment advice to their depositors, for they naturally had an incentive to urge depositors to purchase shares of the issues the bank was underwriting.[35] Finally, these banks would also "dump" excess issues of unmarketable securities on their own trust departments.[36]

Congress passed the Glass-Steagall Act to correct these abuses. The Act is a prophylactic measure designed to prevent commercial banks from being exposed to the dangers which inevitably followed upon their participation in investment banking. "Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system."[37]

B. *Statutory language*

Congress accomplished the separation of commercial and investment banking in sections 16 and 21 of the Glass-Steagall Act. We first ask whether the language of these sections clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged; if so, our inquiry necessarily comes to an end.[38]

Section 16 provides that a bank "shall not underwrite any issue of *securities or stock*" and shall not "purchase . . . for its own account . . . any *shares of stock* of any corpora-

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35 *Hearings, supra* note 32, at 237.

36 *Id.*

37 *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 634, 91 S.Ct. 1091, 1100, 28 L.Ed.2d 367 (1971) [hereinafter cited as *ICI I*].

38 *E.g., Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11, 16, 100 S.Ct. 242, 245, 62 L.Ed.2d 146 (1979).

tion."[39] We can find nothing in the language of this section that explicitly articulates a congressional intent to bar commercial banks from trading in commercial paper. The terms "securities" and "stock" are not defined by the Act; section 16 in no way refers explicitly to notes, the generic financial term which Congress might have used to encompass commercial paper.[40] Indeed, banks are authorized to "discount and negotiate promissory notes, drafts, bills of exchange, and other evidences of debt. . . ."[41] It is clear, then, that section 16 does not prohibit banks from selling or underwriting *all* notes, but *only* "securities or stock"; and the section does not indicate whether the commercial paper at issue in this case is included within that statutory prohibition.

We turn then to section 21 of the Act, which forbids banks from underwriting "stocks, bonds, debentures, notes, or other securities. . . ."[42] Although this statutory provision explicitly refers to "notes," that term is susceptible of at least two interpretations. First, it may refer to a specific type of long-term debt security, one that closely resembles a bond or debenture but is of shorter maturity.[43] A note in this sense, like a bond or a debenture, is issued under an indenture agreement to raise money available for an extended period of time as part of the corporation's capital structure. An investment note

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39 12 U.S.C. § 24 Seventh (Supp. IV 1980) (emphasis added). The Act allows for several exceptions; the one pertinent here is that for "investment securities." *See infra* pp. 145-146 [19a].

40 *See infra* p. 143 [234A] & note 44.

41 12 U.S.C. § 24 Seventh (Supp. IV 1980).

42 12 U.S.C. § 378(a)(1) (1976). If the language of *either* section 16 *or* section 21 must be interpreted to prohibit Bankers Trust's marketing of commercial paper, that interpretation of course governs. *See generally* *ICI II*, *supra*, note 22, 450 U.S. at 62-65, 101 S.Ct. at 984-86.

43 *See, e.g.*, 1 A. Dewing, The Financial Policy of Corporations 180 (4th ed. 1941); G. Munn, Encyclopedia of Banking and Finance 132 (7th ed. 1973).

differs from these other instruments in that it matures more quickly—in a few, rather than twenty or more, years.

Second, the term "notes" is sometimes used generically to refer to *any* promissory instrument regardless of maturity or negotiability.[44] In this sense, commercial paper may also be referred to as a promissory "note." Such a note differs sharply from an investment "note": commercial paper is used to obtain short-term credit for current transactions, rather than capital funds for long-term projects. Its maturity generally ranges from one to two months, and rarely exceeds nine months.[45]

The language of section 21 suggests that Congress intended only to prohibit the marketing of investment notes—*i.e.*, that it intended to use "notes" in its more specific meaning. Each of the terms listed by Congress—"stocks," "bonds," "debentures" and "notes"—refers to a specific type of long-term investment security.[46] In contrast, "notes" in the more general sense would also include financial instruments, such as commercial paper, which have little in common with these long-term investment securities.[47] Moreover, "notes" used in its

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44 *See, e.g.*, G. Munn, *supra*, note 37, at 698 (defining "note" as a "written promise . . . to pay a certain sum of money to the . . . payee").

45 *See also infra* p. 149 [245A] & note 80.

46 "Stocks," of course, represent ownership interests in a corporation. "Bonds" are secured debt instruments, issued under a trust indenture agreement, that bear long-term maturities and are offered to the public in small denominations. "Debentures" differ from bonds only in that they are unsecured.

47 *See Third Nat'l Bank in Nashville* v. *IMPAC, Ltd.*, 432 U.S. 312, 322 & n. 16, 97 S.Ct. 2307, 2313 & n. 16, 53 L.Ed.2d 368 (1977) ("words grouped in a list should be given related meanings"); *Am. Maritime Ass'n* v. *Stans*, 485 F.2d 765, 768 (D.C.Cir. 1973) (same). *Cf. Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307, 81 S.Ct. 1579, 1582, 6 L.Ed.2d 859 (1961) (statutory term "gathers meaning from the words around it").

Similarly, under the familiar principle that where general words follow specific words in an enumeration, the general words are

more general sense would include debt instruments such as bonds and debentures; the explicit statutory reference to the latter would then be redundant.[48] For these reasons, specific inclusion of the terms "stocks," "bonds," and "debentures" suggests that the narrower meaning of the term "notes" was intended. We conclude that the context in which the term "notes" is used strongly implies Congress' intent not to include commercial paper within the sweep of the Act's prohibition.

Both section 16 and section 21 thus demarcate a fundamental division between notes which represent commercial banking

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construed to embrace only items similar to those specifically enumerated, *see, e.g., Harrison v. PPG Inds., Inc.*, 446 U.S. 578, 588, 100 S.Ct. 1889, 1895, 64 L.Ed.2d 525 (1980), the phrase "or other securities would include *only* financial instruments with the economic characteristics of those listed, *see supra* note 46, *not* commercial paper.

The conclusion that commercial paper differs markedly from those instruments which Congress intended to prohibit commercial banks from underwriting depends ultimately upon an analysis of the relevant economic characteristics of these instruments, such as the characteristics noted in text. It is clear that commercial paper differs from the family of specific instruments listed in section 21 of the Act; we explain below the relevance of these differences to the policies wich Congress intended the Act to advance. *See infra* parts IIIC (legislative history) and IIIE (functional analysis of the commercial paper market).

48 *See Ass'n of Am. R.Rs. v. United States*, 603 F.2d 953, 964 (D.C. Cir. 1979) (presumption that "Congress [does] not employ superfluous language").

A third reason to reject a broad definition of the term "note" is that this definition would include a number of instruments in which banks have traditionally traded—for example, certificates of deposit, notes evidencing a mortgage and notes representing commercial loans in connection with a loan syndication. All of these clearly involve a "written promise to pay a certain sum to the payee," *see supra* note 44; their sale by banks would therefore be prohibited by appellees' reading of the statute. Moreover, it makes little sense to argue, as do appellees, that we may escape this quandary by interpreting the Glass-Steagall Act to prohibit only banking practices not otherwise authorized by the banking laws: The banks may only exercise expressly granted powers in any event. *See, e.g., Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972); *Saxon v. Georgia Ass'n of Indep. Ins. Agents, Inc.*, 399 F.2d 1010 (5th Cir. 1968).

transactions—transactions which are, of course, permitted under the Act—and securities, such as investment notes, which commercial banks are prohibited from underwriting. Section 16 indicates this distinction by authorizing commercial banks to negotiate "promissory notes," while forbidding banks to negotiate "securities or stocks." Section 21 makes the distinction by barring banks from trading in specified instruments for raising capital as part of the permanent financial structure of a corporation—stocks, bonds, debentures and notes—while implicitly permitting transactions in other types of debt instruments. And the language of these sections, while not conclusive, strongly suggests that sale of commercial paper should be treated as a "loan" rather than a sale of securities for the purposes of the Act.

C. *Legislative history*

The distinction between commercial loans and securities emerges as well from an analysis of the legislative history. Throughout its debates on the causes of the imperiled state of the banking industry, Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties.[49] The commercial paper market was simply not part of the problem to which the Glass-Steagall Act was addressed.[50] Rather, Congress focused its attention on the commercial banks' participation in "speculative" securities markets: their extensive underwriting of long-term holdings of high risk stocks and bonds.

For example, the Senate Report on the Act notes that "[t]he outstanding development in the commercial banking system during the prepanic period was the appearance of excessive

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49 *See* Federal Reserve Statement, *supra* note 3, at 14-15, J.A. at 233-34.

50 This is particularly remarkable because, at the time the Glass-Steagall Act was passed, almost all commercial paper issued was purchased by commercial banks for their own account. *See* Hurley, *supra* note 5.

security loans, and of over-investment in securities. . . . [A] very fruitful cause of bank failures . . . has been the fact that the funds of various institutions have been so extensively '*tied up' in long-term investments*."[51] Congress condemned "the excessive use of bank credit in making loans for the purpose of *stock speculation*. . . ."[52] In short, the purpose of the Act was to reverse "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*."[53]

The distinction between bank participation in the securities and in the commercial paper markets is also illustrated in Congress' treatment of section 2(b) of the McFadden Act.[54] Section 2(b) limited the amounts of "investment securities" national banks could hold.[55] It is clear, however, that *commercial paper was not considered an "investment security"* under the McFadden Act: banks were left free to trade in commercial

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51 S. Rep. No. 77, *supra* note 30, at 8 (emphasis added).

52 *Id.* at 9 (emphasis added).

53 *Id.* at 4 (emphasis added). The hearings and floor debates of the Act are also replete with evidence that Congress was concerned with banks' speculation in long-term equity and debt securities rather than with their participation in the commercial paper market. *See, e.g.*, 77 Cong. Rec. 3725, 3837 (1933) (remarks of Sen. Glass); *Hearings*, *supra* note 32, at 1006-19; *Operation of the National and Federal Reserve Banking Systems; Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*; 72d Cong., 1st Sess. 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of president of American Bankers Association); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); *id.* at 9911-12 (remarks of Sen. Bulkley) (promotional pressures encouraging over-development of collateral-security loans and over-production of capital securities).

54 Ch. 191, 44 Stat. 1224 (1927).

55 44 Stat. at 1226 (codified at 12 U.S.C. § 24 Seventh (Supp. IV 1980)). The Act restricted bank holdings of the securities of any one obligor to twenty-five percent of the bank's holdings. *Id.* The Glass-Steagall Act further restricted the permissible amounts of these holdings. Ch. 89, sec. 16, 53 Stat. 162, 185 (1933) (later modified).

paper without restriction.[56] It is significant, therefore, that Congress preserved the provisions of the McFadden Act when it passed the Glass-Steagall Act six years later.[57] The legislative history of the Glass-Steagall Act provides no indication that Congress intended to change the McFadden Act's definition of "investment security."[58] Moreover, it is unlikely that Congress would consider commercial paper to be a "security" but *not* an "investment security."[59] Thus, Congress' incorporation of the McFadden Act into the revised banking laws, like other aspects of the legislative history, indicates an intent to continue to leave banks free to deal in commercial paper.

56 Federal Reserve Statement, *supra* note 3, at 9, J.A. at 228; 67 Cong. Rec. 3232 (1926); H.R. Rep. No. 83, 69th Cong., 1st Sess. 3-4 (1926). Congress was legislating to control national banks' underwriting activities, which had sprung up in the early 1900s. In contrast, these banks had dominated the commercial paper market since the middle 19th century. *See* Federal Reserve Statement, *supra* note 3, at 10, J.A. at 229; A. Greef, The Commercial Paper House in the United States at 6-7, 15-18, 403-05 (1938).

57 Ch. 89, sec. 16, 53 Stat. 162, 185 (1933).

58 *See* S. Rep. No. 77, *supra* note 30, at 16 (banks permitted to purchase and sell investment securities "to the same extent as heretofore").

59 The conclusion that commercial paper is not a "security" or "stock" would follow *a fortiori* from the conclusion that commercial paper is not an "investment security." If commercial paper is a security but not an investment security, banks would be entirely forbidden from purchasing, selling, or underwriting commercial paper, while permitted, subject to the regulation of the Comptroller of the Currency, to purchase or sell corporate debt instruments. This would be quite anomalous, for corporate debt instruments threaten to a far greater degree to cause the evils at which the Glass-Steagall Act is aimed. Moreover, if commercial paper were deemed to be a "note" within section 21 of the Glass-Steagall Act, it ought also to be a "marketable obligation[ ] evidencing indebtedness . . . in the form of [a] note[ ]"—*i.e.*, an "investment security"—under section 16. That the legislative history and administrative implementation of the McFadden Act indicate clearly that commercial paper is not an "investment security" implies therefore that it should not be considered a "note" for the purposes of the Glass-Steagall Act.

D. *The Analogy to the Securities Laws*

Plaintiffs suggest that we may infer Congress' intent from its use of the term "security" in two contemporaneous statutes—the Securities Act of 1933 and the Securities Exchange Act of 1934. Both acts define "security" to include "any note."[60] There is no reason, however, to assume that Congress intended that term to bear the same meaning in these different statutory contexts. Congress enacted the Glass-Steagall Act primarily to protect *bank depositors*.[61] By contrast, "[t]he primary purpose of the [Securities Acts] of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and *the need for regulation to prevent fraud and to protect the interest of investors*."[62]

Therefore, although Congress used the term "securities" in both the Glass-Steagall and the Securities Acts, different interpretations of "securities" may follow upon the differing regulatory purposes behind the Acts.[63] "Because securities transactions are economic in character Congress intended the application of [the Securities Acts] to turn on the *economic realities underlying a transaction*. . . ."[64] Similarly, the Court has defined the term "securities" in the Glass-Steagall Act by

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60 15 U.S.C. § 77b(1)(1976) (Securities Act); *id.* § 78c(a)(10) (Securities Exchange Act).

61 *ICI II, supra* note 22, 450 U.S. at 61 & n. 27, 101 S.Ct. at 984 & n. 27. *See generally supra* pp. 141-143 [230A-232A].

62 *United Housing Found., Inc.* v. *Forman*, 421 U.S. 837, 849, 95 S.Ct. 2051, 2059, 44 L.Ed.2d 621 (1975) (emphasis added).

63 The Supreme Court's recent interpretations of these provisions of the Glass-Steagall Act make no reference at all to the securities laws. *See generally ICI I, supra* note 37; *ICI II, supra* note 22.

64 *United Housing Found., Inc.*, 421 U.S. at 849, 95 S.Ct. at 2059 (emphasis added).

analyzing the economic policy behind the Act—to protect bank depositors from the hazards which ensue when commercial banks enter the investment banking business.[65] In short, the Glass-Steagall Act uses the term "security" to fence off investment banking activities from commercial banks; the securities laws use the term to define the capital markets whose economic functioning is to be regulated by the securities laws. Clearly, the scope of the term may differ in these differing contexts. We must assign the term "security" a different meaning in the Glass-Steagall and the Securities Acts if a different interpretation is called for by the respective policies of those Acts.[66]

The Supreme Court recently reaffirmed this approach to the Securities Acts in *Marine Bank* v. *Weaver.*[67] "The [Securities Exchange] Act was adopted to restore *investors' confidence in the financial markets.* . . . We have repeatedly held that the test [of whether an instrument is a "security"] 'is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect.' "[68] Therefore, "[e]ach transaction must be analyzed and evaluated on the basis of the content of

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65 *See infra* p. 148 [242A-244A] & notes 72-76.

66 Appellees emphasize that, because Congress *defined* "security" in the Securities Act to include "any note," it must have intended "security" in the Glass-Steagall Act to mean the same thing. But all the example of the Securities Acts shows, of course, is that Congress is capable of using "securities" to include "all notes" when it clearly defines the term in that way. Indeed, the example of those Acts suggests that, if Congress had intended so sweeping a definition of "security" in the Glass-Steagall Act, it would have enunciated such a definition in the Act. *Cf. American Tobacco Co.* v. *Patterson*, U.S. at n. 6, 102 S.Ct. 1534,at 1539 n. 6, 71 L.Ed.2d 748 ("fundamental distinction" should not be imported into a statute unless Congressional intent is clearly expressed); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 572, 99 S.Ct. 2479, 2487, 61 L.Ed.2d 82 (1979) ("when Congress wished to provide [remedy], it knew how to do so and did so expressly").

67 ____ U.S.____, 102 S.Ct. 1220, 71 L.Ed.2d 409 (1982).

68 *Id.* at ____, 102 S.Ct. at 1222 (emphasis added) (citations omitted).

the instruments in question, the purposes intended to be served, and the factual setting as a whole."[69]

In deciding that a certificate of deposit was not a security, *Marine Bank* noted two facets of the economics of these certificates: first, holders receive a fixed rate of interest rather than dividends based on profits; second, "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under . . . the federal securities laws since the holders of bank certificates of deposit are abundantly protected under federal banking laws."[70] In short, the Court focused on the potential economic gains and losses of the *investors*, who are the intended beneficiaries of federal securities regulation, in deciding whether the purposes of that regulation would be furthered by its application to the instrument in question. A different focus of analysis is called for under the Glass-Steagall Act, which aims at protecting the integrity of *banks* and the financial resources of *depositors* rather than *investors*.

We conclude that the meaning of the term "securities" under the securities laws is of little immediate relevance to the problem before us; rather, the example of these laws suggests the need for a careful economic analysis of the commercial paper market itself.

E. *Functional Analysis of Commercial Paper*

The language and the legislative history of the Glass-Steagall Act strongly suggest that commercial paper should be viewed as a loan rather than as a "security" for the purposes of the Act. However, as we have seen, neither the language nor direct evidence from the legislative history is decisive of the question before us. There is no foolproof formula by which we can decide whether the commercial paper marketed by Bankers Trust constitutes a "security." Rather, as the Board observed,

> a broad generic or literal reading of the term "security" would likely encompass a number of instruments that

69 *Id.* at ____, n. 11, 102 S.Ct. at 1225, n. 11.

70 *Id.* at ____, 102 S.Ct. at 1225.

> banks routinely deal with in the course of their business and would, consequently, be contrary to the basic purpose of the Act. On the other hand, a highly technical or formalistic approach might permit evasions of the mandate of Congress.[71]

Because neither the literal language of the statute nor other expressions of congressional intent available to us directly indicate whether commercial paper is a "security," it is necessary to conduct a "functional analysis" of Bankers Trust's commercial paper to resolve this question. The problem becomes whether classifying commercial paper as a "security" would further the policies of the Act. As the Board phrased this inquiry:

> [I]f a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security.[72]

In adopting this functional analysis, the Board followed the Supreme Court's reasoning in its recent cases construing the Glass-Steagall Act. In *Investment Company Institute* v. *Camp* (*ICI I*) the Court noted that

> Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities. The Glass-Steagall Act reflected a determination that policies . . . which might otherwise support the entry of commercial banks into the investment banking business were outweighed by the "hazards"

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71 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 237.

72 *Id.*

> and "financial dangers" that arise when commercial banks engage in the activities proscribed by the Act.[73]

Thus, if confronted with a banking practice which involves the sale of securities and for that reason threatens the "hazards" at which the Act is aimed, neither the Federal Reserve Board nor this court is free to "balance" these hazards against the perceived benefits of the proposed practice. If the practice does *not* threaten to cause these hazards, however, we need undertake no such balancing. Rather, we effectuate the will of Congress by concluding that the proposed banking practice is not within the scope of the statutory proscription.

For example, in *ICI I* the Court found that the bank's sale of participations in a bank-sponsored mutual fund posed the dangers that the Glass-Steagall Act was designed to prevent; the Court concluded that these participations were securities within the meaning of the Act.[74] Once these participations were found under this functional analysis to be "securities," the "literal language" of the Act prohibited sale by the bank.[75]

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73 *ICI I, supra* note 37, 401 U.S. at 629-30, 91 S.Ct. at 1098.

74 *Id.* at 635-38, 91 S.Ct. at 1101-02.

75 *Id.* at 639, 91 S.Ct. at 1103. *See also ICI II, supra* note 22, 450 U.S. at 65-66, 1-1 S.Ct. at 986 (analyzing *ICI I*) ("This Court's . . . determination [that the units of participation were securities] led inexorably to the conclusion that § 16 had been violated."). *ICI II* posed a different problem of statutory interpretation, as the Court itself noted. *Id.* at 66, 101 S.Ct. at 986. There, it was indisputable that the transactions under scrutiny involved "securities"; the question before the Court was whether the banks were "engaged in the business of issuing, underwriting, selling, or distributing" securities. Again, the Court embarked upon an analysis of the "hazards contemplated [by] Congress in enacting the Glass-Steagall Act" in order to conclude that the Act had not been violated. *Id.* at 66-67, 101 S.Ct. at 986-87.

Because we find that the commercial paper marketed by Bankers Trust is not a "security," we need not reach the issue, which arose in *ICI II*, of whether the bank is engaged in "underwriting" within the meaning of the Glass-Steagall Act.

The Federal Reserve Board, in resolving the present case, therefore correctly focused on whether the commercial paper marketed by Bankers Trust functioned economically as a loan or as a security. Only if commercial paper displayed the economic characteristics of a "security" would the marketing of commercial paper by Bankers Trust cause the hazards the Act was designed to prevent. The Board concluded that, in all relevant respects, the commercial paper had the economic characteristics of a loan.[76] We agree.

It is useful to review the traditional lending functions of commercial banks. The commercial lender extends ***short-term*** credit to businesses to finance immediate needs for working capital.[77] To assure itself of timely repayment, the commercial bank carefully evaluates the credit-worthiness of the borrower and the borrower's representations as to the use of funds. In recent years, the lender has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies.[78]

We find that the commercial paper at issue here has the economic characteristics of a traditional loan. Purchase of commercial paper, like lending by a commercial bank, represents a very reliable means by which the lender may earn a return on excess cash over a short period of time. Several features of the commercial paper market are salient in this respect.

First, the default rate on commercial paper is extremely low: only highly solvent corporations, with the best possible bond ratings, are able to market commercial paper. Indeed, the default rate on commercial paper is much lower than that on

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76 Statement, *supra* note 3, at 17-20, J.A. at 236-39.

77 *See, e.g.*, D. Hayes, Bank Lending Policies 89-91 (1977); J. Culbertson, Money and Banking 308-09 (2d ed. 1977). In considering the Glass-Steagall Act, Congress emphasized the distinction between short-term and long-term capital financing. *See supra* p. 145 [237A] & notes 52-53.

78 *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Lawyers 537, 538 (1977).

ordinary commercial loans made to high-grade commercial customers.[79]

Second, Bankers Trust commercial paper, like most commercial loans, is of very short maturity: it is generally redeemable at face value within 30 to 90 days.[80] Short maturity not only makes commercial paper a very liquid investment; it also reduces risk, because the financially strong corporations which can issue commercial paper are unlikely to deteriorate over the short period during which purchasers must hold the paper.

Third, because commercial paper is sold by Bankers Trust in denominations averaging one million dollars or more,[81] this paper is placed only with sophisticated purchasers—large institutions such as pension funds, money market mutual funds, insurance companies and nonfinancial corporations with large amounts of idle cash.[82] These purchasers, like commercial banks, are well able to evaluate the riskiness of the investments by verifying representations about the issuers. Three indepen-

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79 Federal Reserve Statement, *supra* note 3, at 3, J.A. at 222; Hurley, *supra* note 5, at 526-29. The Board's empirical studies found that the default rate on commercial paper is only a fraction of that on commercial loans. Companies which began to experience financial difficulties, such as Chrysler Financial Corp. and International Harvester Credit, must withdraw from the commercial paper market. Ironically, these corporations turn to commercial banks to meet their needs for current funding.

80 *See* Report from the Board's On-site Investigation of Bankers Trust 2 (8 May 1980) (average maturity of Bankers Trust notes 60 days), J.A. at 200 [hereinafter cited as Report]; Federal Reserve Statement, *supra* note 3, at 2, J.A. at 221. *See also* Hurley, *supra* note 5, at 530; Comment, *supra* note 5, at 364. According to a Federal Reserve Board survey, the maturities of short-term commercial and industrial loans range from 36 to 105 days. 67 Fed. Res. Bull. A26 (Dec. 1981).

81 *See* Report, *supra* note 80, at 2, J.A. at 200. The minimum denomination Bankers Trust will sell is $100,000.

82 Hurley, *supra* note 5, at 529; Comment, *supra* note 5, at 362-66.

dent rating services also conduct thorough periodic investigations of issuers' financial condition.[83]

For all these reasons, investment in commercial paper, far from resembling securities speculation, is less risky even than banks' ordinary commercial lending.[84] The key difference between the commercial paper sold by Bankers Trust and the traditional lending of commercial banks is that capital is lent by other investors rather than by the bank.[85] In the traditional loan transaction, the commercial bank *purchases* commercial paper; in the present case, the bank acts as agent in the *sale* of commercial paper. The bank is simply on the other side of the transaction. The question which faced the Board is whether commercial paper should be considered a "security" merely because the bank acts as the seller rather than the purchaser of the commercial paper—*i.e.*, whether the role of the bank in and of itself makes the transaction one prohibited by the Glass-Steagall Act.[86]

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83 *See* sources cited at note 82 *supra*.

84 Notably, securities differ strikingly from loans in all three respects. First, purchasers of securities, unlike purchasers of commercial paper, may liquidate their holdings, if at all, only at whatever price the market is currently paying for the stock. Second, because this price will fluctuate with the fortunes of the firm and with general economic conditions, holding securities is risky (though of course the degree of risk will depend on the profitability of the enterprise and the terms of the security agreement). Third, securities are generally available in much smaller denominations than commercial paper, so that they may be traded by the public on the open market.

85 Federal Reserve Statement, *supra* note 3, at 19, J.A. at 238. When Congress passed the Glass-Steagall Act, this difference was less marked than it has been in recent years: banks not only arranged loans in private transactions, but also purchased the vast bulk of instruments sold through the commercial paper market. *See id.* at 18, J.A. at 237; Hurley, *supra* note [illegible], at 529. *Compare supra* p. 148 [244A] & n. 78 (in commercial bank loan, lender may be either the bank itself or a syndicate of other lenders).

86 *See Becker*, 519 F. Supp. at 615-16.

We agree with the Board that Bankers Trust may sell as well as purchase commercial paper. The bank's role as seller does not threaten the bank with those dangers which the Glass-Steagall Act was designed to prevent. Because commercial paper is like a loan rather than a security, marketing of commercial paper by the bank does not have the same economic impact on the bank as would marketing of securities.

This is confirmed by an analysis of the dangers which the Glass-Steagall Act was designed to prevent.[87] One such danger was that bank underwriting of *securities* may "tie up" depositors' funds in speculative securities. Bankers Trust's sale of commercial paper does not create this danger because of the features of commercial paper already noted. First, the bank acts simply as an agent in the sale of commercial paper; it does not agree to purchase the paper on its own account—*i.e.*, with the funds of depositors.[88] Second, commercial paper is of prime quality, sold only by corporations with well-established credit ratings: commercial paper is not a "speculative" holding.[89] Third, commercial paper is held by the lender only for 30 to 90 days:[90] the lender may readily convert his holdings to cash and does not bear the risk of long-term fluctuations in the value of the enterprise.

The other set of dangers addressed by the Glass-Steagall Act comprises the conflicts of interest that arise when a commercial bank underwrites securities.[91] Again, Bankers Trust does not face these conflicts.

First, the bank cannot use its credit facilities in order to facilitate sale of its commercial paper. Because the interest on a commercial loan is higher than that paid out on commercial

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87 *See supra* pp. 141-43 [230A-232A].

88 Report, *supra* note 80, at 4, J.A. at 202; Federal Reserve Statement, *supra* note 3, at 2.

89 *See supra* pp. 148-149 [244A-246A].

90 *See supra* pp. 149 [245A-246A].

91 *See supra* pp. 142-143 [231A-232A].

paper, a purchaser of commercial paper would not use a commercial loan to finance its purchases.[92] Conversely, the bank is under no incentive to advance unsound loans to shore up its issuers of commercial paper, because these issuers must be, by the nature of the commercial paper market, financially sound.[93]

Second, Bankers Trust is not in a position to abuse its reputation for prudence, or give unreliable financial advice to its depositors, in order to promote the sale of commercial paper. Commercial paper is purchased only by large sophisticated buyers who are capable themselves of evaluating the wisdom of their investment.[94] Moreover, commercial paper is very low-risk, and is issued only by very solvent corporations about whose financial prospects information is widely available.[95] It is inconceivable that a commercial bank such as Bankers Trust could, under these conditions, seek improperly to influence potential purchasers of commercial paper.[96]

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92 *See* Guidelines, *supra* note 13, at 29334. *See also* Report, *supra* note 80, at 4, J.A. at 202 (no evidence that funds borrowed from Bankers Trust are used to purchase its commercial paper).

93 *See supra* pp. 148-149 [244A-246A].

94 *See supra* p. 149 [245A-246A].

95 *See supra* p. 148 [244A-245A].

96 Finally, Bankers Trust may not "dump" its commercial paper through its trust department, for the Federal Reserve Guidelines prohibit bank sales of commercial paper to fiduciary accounts to which the bank gives investment advice. *See* Guidelines, *supra* note 13, at 29335 (Guideline #7). Insofar as the conflict of interest presented here may be entirely eliminated by an authorized regulation of the Board, it can hardly be said to pose one of the "subtle hazards" against which the Act is directed. *ICI I, supra* note 37, 401 U.S. at 630, 91 S.Ct. at 1098. *See also ICI II, supra* note 22, 450 U.S. at 66-67, 101 S.Ct. at 986 (relying on Board guidelines in finding no "underwriting" by banks); *cf. Marine Bank*, ___ U.S. at ___, 102 S.Ct. at 1225 (regulation of certificates of deposit by securities laws unnecessary because of extensive federal banking regulation).

Finally, the bank's reputation for prudence will not suffer by its association with the issue of commercial paper. Commercial paper is a highly sound short-term investment. And even if a commercial paper issuer were to default, the sophisticated purchasers of commercial paper will understand that this paper is not backed by the guarantees on commercial bank deposits.

The Board's "functional analysis" leads inexorably to the conclusion that Bankers Trust's commercial paper is not a "security" within the meaning of the Glass-Steagall Act. Transactions in commercial paper display the key economic characteristics of a commercial bank loan; and, because of these characteristics, Bankers Trust's dealings in commercial paper pose none of the hazards the Glass-Steagall Act was designed to prevent.

IV. CONCLUSION

We thus agree with the Board that Bankers Trust may continue to deal in commercial paper without violating the Glass-Steagall Act. The commercial paper it markets is not a "security" within the prohibitions of the Act. Moreover, our reasoning applies to other commercial paper which falls within the Board's guidelines—*i.e.*, prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public.[97] Commercial banks which deal in this paper are not subject to the risks which the Glass-Steagall Act was designed to prevent. We hold therefore that commer-

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97 *See* Guidelines, *supra* note 13, at 29334 (Guideline # 1). The Board's Guidelines, in addition to defining permissible types of commercial paper and permissible purchasers and sellers, require forms of disclosure, record-keeping, and credit analysis by commercial banks. *See supra* p. 8. These requirements are directed against the danger that sale of third-party commercial paper might involve "unsafe or unsound [banking] practices." In finding that the transactions regulated by the Guidelines do not involve a sale of *securities*, we do not rely on these additional requirements.

cial banks may sell third party commercial paper provided that they comply with the Board's guidelines.

It is appropriate to note, however, the limits to this holding. It is conceivable that another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a "security" under the Glass-Steagall Act. Commercial bank involvement in the market for such commercial paper may well undermine bank solvency or create unavoidable conflicts of interest. Moreover, the present case does not require us to decide whether Bankers Trust is engaged in "underwriting." A commercial bank is permitted to underwrite commercial paper so long as commercial paper is not a "security." If other species of commercial paper prove to be a "security," however, the issue what constituted "underwriting" of commercial paper would then have to be decided.

Our opinion does not touch directly on other species of commercial paper. As the commercial paper market and banking practices continue to evolve, the Board will be called upon to determine in varying fact situations the scope of activities that Congress intended to permit banks to undertake. But these hypothetical situations are irrelevant to the problem before us. Because the Board correctly applied its functional analysis to the instant case, the judgment of the district court is *Reversed*.

ROBB, *Senior Circuit Judge*, dissenting:

I dissent. In my opinion the majority's holding contravenes the fundamental policy of the Glass-Steagall Act. That Act seeks to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions. The majority decision violates this separation of functions by finding no difference under the Act between a lender in a commercial loan transaction and a seller in the sale of third-party commercial paper.

Although offering various justifications, the majority ultimately rests its holding on a "functional analysis" of Bankers

Trust's third-party commercial paper sales. In its functional analysis, the majority dismisses the difference between the bank's role as "purchaser" in a commercial loan transaction and its role as "seller" in a third-party commercial paper transaction as a case of the bank "simply [being] on the other side of the transaction." *Ante* at 150 [27a]. This distinction, however, is determinative under the Act. Through the Act Congress sought a complete separation of commercial banking from investment banking. *See Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629, 632, 91 S.Ct. 1091, 1098, 1099, 28 L.Ed.2d 367 (1971). *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. 46, 62, 101 S.Ct. 973, 984, 67 L.Ed.2d 36 (1981). The critical distinction between commercial banking and investment banking is the bank's role in the transaction.

When a bank lends money it is the investor. Following a thorough credit analysis of the potential borrower, the bank decides whether to approve the loan. A loan that the bank has approved and funded constitutes an asset of the bank for which the bank has placed its funds at risk. The bank's generation of income and collection of principal are dependent on the wisdom of the bank's credit decision, the adequacy of the loan provisions, and the bank's perseverance in collecting the loan.

In contrast, when a bank markets third-party commercial paper, it is the seller, not the investor. As seller, the bank has less incentive to conduct a thorough credit analysis of the commercial paper issuer because the bank, unlike an investor, does not place its funds at risk. The bank earns its fee upon closing the sale of the commercial paper. Once the sale is complete, the bank has no direct financial interest in the issuer's ability to meet its commercial paper obligations.

Ignoring the differences in the bank's roles as lender and as seller, the majority characterizes commercial loans as "short-term" transactions and then avers that selling commercial paper is no different than making a commercial loan because both transactions have short maturities. *Ante* at 143-144 [244A-246A]. This analysis fails for two reasons. First, any

interpretation of the Act must focus on the bank's role in the transaction with a view to maintaining the Act's separation of banking functions. The majority's focus on maturities provides no help in determining whether the bank's role in the transaction violates the Act. Second, the basic premise of the majority's analysis is incorrect. Commercial lending is not limited to short-term loans. Longer maturity loans for the acquisition of fixed assets and for permanent increases in working capital are important commercial lending services which the majority conveniently ignores. *See* D. Hayes, *Bank Lending Policies*, 89, 107, 109 (2d ed. 1977); G. Munn, *Encyclopedia of Banking and Finance* 892 (7th ed. 1973). *See generally Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

Similarly, an analogy between commercial paper sales and commercial loans, based on low default rates and the sophistication of the investors, *ante* at 144 [25a-27a], is not helpful. Relying on these factors, a bank could transform "transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks." *A.G. Becker, Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F.Supp. 602, 615 (D.D.C. 1981).

The majority says that analysis of the hazards of mixing commercial and investment banking "confirms" the result reached through its functional analysis. I reach the opposite conclusion. In *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 91 S.Ct. 1091, 28 L.Ed.2d 367 (1971), the Supreme Court lists several hazards that arise when commercial banks become peddlers of securities. First, commercial banks may suffer losses from imprudent security investments. *Id.* at 630, 91 S.Ct. at 1098. Second, "the bank's salesman's interest might impair its ability to function as an impartial source of credit." *Id.* at 631, 91 S.Ct. at 1099. Third, commercial banks may lose customer good will if their depositors suffer losses on investments made in reliance on the bank's involvement in the transaction. *Id.* Fourth, commercial banks may use their reputation for prudence to further their securities sales and subject that reputation to the risks necessarily incident to the investment banking business. *Id.* at 632, 91 S.Ct. at 1099. Finally,

the bank's promotional interests could conflict with its commercial banker obligation to render disinterested investment advice. *Id.* at 633, 91 S.Ct. at 1100.

The majority makes short work of the hazards discussed in the *Camp* decision. Those hazards, in the majority's view, are irrelevant here because commercial paper is a "prime quality", "very low-risk" investment, issued by "financially sound" issuers, and sold to "sophisticated" investors. *Ante* at 150-151 [28a-30a]. The majority's self-fulfilling analysis misses the point. "Prime quality" and "very low-risk" are characterizations that are justified only after an investment has been terminated without any investor loss. The drafters of the Act were certainly more wary of such characterizations in 1933 than the majority is today. The Act has no provision permitting bank sales of securities which are "prime quality" or "very low-risk".

To determine whether the bank's sale of third-party commercial paper involves the hazards that the Act seeks to prevent, we must take the perspective of the Act's drafters. The recent Penn Central experience provides such a perspective. *See generally* Staff of Securities & Exchange Commission, 92d Cong., 2d Sess., *Report to Special Subcomm. on Investigations of the House Comm. on Interstate and Foreign Commerce, The Financial Collapse of the Penn Central Company* (Subcomm. Print 1972) [hereinafter cited as *Penn Central Report*]. As a consequence of its bankruptcy on June 21, 1970 the Penn Central Transportation Company defaulted on $82.5 million in commercial paper. *Id.* at 1. Goldman, Sachs & Co., the nation's largest commercial paper dealer, had sold the commercial paper during the seven months preceding the bankruptcy. *Id.* at 290. The National Credit Office, a wholly-owned subsidiary of Dun & Bradstreet, Inc., had given Penn Central's commercial paper its highest rating, "prime", until June 1, 1970. *Id.* at 283. The investors, whom Goldman, Sachs & Co. described as "sophisticated" and "capable of making their own investment decisions," had purchased Penn Central commercial paper in $100,000 denominations. *Id.* at 290.

A review of the *Camp* warnings in light of the Penn Central experience presents a picture very different from that which the

majority draws. First, although Bankers Trust makes no commitment to purchase unsold commercial paper, it makes clear in its promotional letter to commercial paper issuers that such purchases are within the ambit of its investment services.

> However, in those rare occasions in which we would be unable to satisfy all of [the issuer's] requirements through the placement of paper with investors, we may, from time-to-time and without prior commitment, lend [the issuer] money at the commercial paper rate, and take back a commercial paper note.

(J.A. at 61). *See also* J.A. at 27, 50. The majority states that bank purchases of commercial paper would not present a problem because commercial paper is "prime quality, [is] sold by corporations with well-established credit ratings," and is a short-term investment. *Ante* at 150 [274A-279A]. Yet a bank's purchase of Penn Central's commercial paper which fit the majority's criteria just three weeks before it became worthless, would have been a perfect example of the hazard of "imprudent investment" that the Act seeks to prevent.

Second, the majority states that commercial paper issuers are "financially sound" companies and, therefore, have no need for commercial loans to strengthen their financial position. *Ante* at 150-151 [274A-279A]. However, as the Penn Central case demonstrates, commercial paper issuers are not exempt from financial difficulties. A bank's interests in handling the issuer's commercial paper sales and in protecting the bank's reputation for sound financial decisionmaking could "distort" its credit decisions or lead to unsound loans" to issuers for whom the bank regularly sells commercial paper. *Investment Co. Institute* v. *Camp*, 401 U.S. at 637, 91 S.Ct. at 1102.

The third hazard discussed in the *Camp* decision arises when a bank sells third-party commercial paper under any circumstances less idealistic than those which the majority envisions. Bank depositors who are financially able to purchase commercial paper in large denominations are likely to be among the bank's most important and influential clientele. Loss of their good will as a result of losses on investments which the bank

recommended and sold could be detrimental to the bank's commercial operations.

Finally, the majority makes the indisputable statement that when a bank sells "very low-risk" commercial paper of "very solvent" corporations to "large, sophisticated" investors the bank is not in a position to abuse its reputation for prudence or to give unreliable financial advice. *Ante* at 150 [247A-249A]. However, commercial paper sales that initially fit the majority's criteria may, before the investors are repaid, create hazards that the Act seeks to prevent.

Goldman, Sachs & Co. sold $5 million of the commercial paper of Penn Central, the nation's fourth largest corporation, to American Express Company, a sophisticated investor, on May 1, 1970. *Penn Central Report* at 286, 291. That sale, following several indications of major problems at Penn Central, *id.* at 279-86, and preceding the Company's collapse by just seven weeks, demonstrates the hazards present when there is a financial incentive to give unreliable advice. Had Bankers Trust been Penn Central's securities peddler, the association with Penn Central's collapse together with the resulting lawsuits which the bank would have had to defend would have severely damaged the bank's reputation for financial prudence. *See* Comment, *The Commercial Paper Market and the Securities Acts*, 39 U.Chi.L.Rev. 362, 378-79 nn. 112-13 (1972).

We must analyze the Act with the intent of its drafters as our guide. The Act was a "drastic step", *Investment Co. Institute* v. *Camp*, 401 U.S. at 629, 91 S.Ct. at 1098, taken during a bleak period in our country's banking history. Its drafters intended a complete separation of commercial banking from investment banking without regard to the likely "soundness" of the securities which a bank might sell. Senator Bulkley stated this uncompromising position at the time of the Act's passage: "If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep the banks out of the investment security business." *Investment Co. Institute* v. *Camp*, 401 U.S. at 634, 91 S.Ct. at 1100 (quoting 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley)). Permitting a bank

to sell third-party commercial paper presents the same hazards that "Congress determined . . . made it necessary to prohibit . . . [investment banking] activity to commercial banks." *Investment Co. Institute* v. *Camp*, 401 U.S. at 636, 91 S.Ct. at 1101. As a result, we must look closely to determine whether the Act prohibits banks from selling third-party commercial paper.

Unlike the majority, I find the Act's language helpful in determining whether commercial paper is a "note" or "security". For our purposes the Act raises two issues. The first issue is whether commercial paper is an instrument with which the Act is concerned—"stocks, bonds, debentures, notes, or other securities," 12 U.S.C. § 378(a)(1) (1976). The second issue is whether Bankers Trust is engaged in the "issuing, underwriting, selling, or distributing," *id.*, activities which the Act prohibits.

The majority characterizes the terms "stocks", "bonds", "debentures", and "notes" as "specific type[s] of long-term investment securit[ies]." *Ante* at 143-144 [234A]. The majority concludes that a broader definition of the term "notes" would be inappropriate because it would include instruments such as commercial paper "which have little in common with these long-term investment securities." *Ante* at 144 [234A]. The majority's reliance on maturities to force a narrow meaning onto the terms of the Act is misplaced. The Supreme Court has interpreted the Act's terms broadly.

> [N]othing in the phrasing of either § 16 or § 21 . . . suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Investment Co. Institute v. *Camp*, 401 U.S. at 635, 91 S.Ct. at 1101. *See also Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. 986. The terms "stocks", "bonds", "debentures", and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the

breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments which a corporation might seek to market. Relying "squarely on the language . . . of the Glass-Steagall Act," *Board of Governors of Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. at 65, 101 S.Ct. at 986. I would find that commercial paper is a type of instrument with which the Act is concerned.

Although analysis of the Act's terms and of the hazards with which the Act is concerned requires a finding that commercial paper is a "note or other security" under the Act, our inquiry is not complete. There remains the second issue of whether Bankers Trust's commercial paper sales is an activity which the Act prohibits. However, neither the Federal Reserve Board nor the District Court reached this second issue. *A.G. Becker Inc.* v. *Board of Governors of Federal Reserve System*, 519 F. Supp. 602, 616 n. 10 (D.D.C. 1981). Therefore the second issue is not before us on this appeal.

I would affirm the District Court's finding that commercial paper is a "note or other security" under the Act, and would remand this case for the further determinations suggested in this dissent.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-1493, 81-2070, 81-2096,
80-2314 and 81-2058

February 2, 1983

A.G. BECKER INCORPORATED,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

Before:

TAMM and WILKEY, *Circuit Judges*,
and ROBB, *Senior Circuit Judge*.

ORDER

On consideration of the joint petition for rehearing of A.G. Becker, Inc. and the Securities Industry Association, filed December 17, 1982, it is

ORDERED by the Court that the aforesaid petition is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner
Chief Deputy Clerk

Senior Circuit Judge Robb did not participate in the foregoing order.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 80-2258, 81-1493, 81-2070, 81-2096,
80-2314 and 81-2058

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A.G. BECKER INCORPORATED,

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BOARD OF GOVERNORS OF THE
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SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, et al.,

Respondents.

Before:

ROBINSON, *Chief Judge,* WRIGHT, TAMM,
MACKINNON, WILKEY, WALD, MIKVA, EDWARDS, GINSBURG,
BORK and SCALIA, *Circuit Judges.*

ORDER

The joint suggestion for rehearing *en banc* of A.G. Becker, Inc. and the Securities Industry Association has been circulated to the full Court. A majority of the Court has not voted in favor thereof. On consideration of the foregoing, it is

ORDERED by the Court *en banc* that the aforesaid suggestion is denied.

Per Curiam

For The Court

GEORGE A. FISHER, *Clerk*

By: Robert A. Bonner

Circuit Judges MacKinnon and Mikva would grant the suggestion for rehearing *en banc*.

Chief Judge Robinson and Circuit Judges Wald, Ginsburg and Bork did not participate in the foregoing order.

No. 82-1766

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, ET AL.,
PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

REX E. LEE
Solicitor General

J. PAUL MCGRATH
Assistant Attorney General

ANTHONY J. STEINMEYER
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel

Board of Governors of the Federal Reserve System
Washington, D.C. 20551

QUESTION PRESENTED

Whether the court of appeals correctly upheld a ruling by the Board of Governors of the Federal Reserve System that a certain type of commercial paper—short-term promissory notes issued by large, financially sound businesses in very large denominations to meet their current needs and sold to a small number of financially sophisticated purchasers that regularly purchase short-term credit instruments—is in economic reality a commercial loan and not a security for purposes of the Glass-Steagall Act.

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In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1766

SECURITIES INDUSTRY ASSOCIATION, ET AL., PETITIONERS

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-38a) is reported at 693 F.2d 136. The opinion of the district court (Pet. App. 39a-64a) is reported at 519 F. Supp. 602. The statement of the Board of Governors of the Federal Reserve System denying the petitions to initiate enforcement action (Pet. App. 65a-86a) is not reported. The Board's Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks (Pet. App. 87a-93a) is reported at 46 Fed. Reg. 29333.

JURISDICTION

The judgment of the court of appeals was entered on November 2, 1982. A petition for rehearing was denied on February 2, 1983 (Pet. App. 95a-98a). The petition

for a writ of certiorari was filed on April 29, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

1. Section 16 of the Banking Act of 1933 (the "Glass-Steagall Act"), 12 U.S.C. (Supp. V) 24 Seventh, provides in pertinent part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any issue of securities or stock * * *.[1]

2. Section 21 of the Glass-Steagall Act, 12 U.S.C. 378(a)(1), provides in pertinent part:

> [I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits * * *.

STATEMENT

1. The term "commercial paper," as used herein, refers to promissory notes that are of prime quality, bear very short-term maturities (usually 60 days or less), and are issued by large, well-known, financially strong corporations to obtain funds for seasonal or other current needs. Commercial paper is not offered to the general public, but rather is sold to large, financially so-

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[1] Section 5 of the Act, 12 U.S.C. 335, provides that state-chartered banks that are members of the Federal Reserve System shall be subject to the same limitations and conditions with respect to dealing in securities that are applicable to a national bank.

phisticated purchasers, predominantly institutions such as money market mutual funds, pension funds, and bank trust departments. Corporations issuing commercial paper place the paper with purchasers either directly or through dealers.[2] Commercial paper that is placed through dealers is sold in very large denominations, usually no smaller than $100,000 and averaging $1 million or more. Pet. App. 4a, 65a-66a; see also Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 527-528 (June 1977) ("Hurley").

Because of its very short maturity and because it represents obligations of only the largest, best-known corporations with established credit ratings, commercial paper generally is a very low risk instrument. The rates paid on commercial paper are usually somewhat lower than the prime rate paid on short-term bank loans and slightly higher than the rates on short-term obligations of the United States. Pet. App. 65a-66a, 89a; see also Hurley, *supra*, 63 Fed. Res. Bull. at 525. Commercial paper is not registered pursuant to the Securities Act of 1933, and dealers that engage exclusively in placing commercial paper are not subject to the broker-dealer registration requirements of the Securities Exchange Act of 1934. 15 U.S.C. 77c(a)(3), 78c(a)(10), 78*o*(a)(1).

2. During 1978, Bankers Trust Company, a New York-chartered member bank of the Federal Reserve System, began placing commercial paper of corporations not related to it ("third party commercial paper") as agent of the issuers. Bankers Trust does not commit to purchase for itself any unsold amounts of commercial paper it attempts to place, but does extend credit to the corporations whose paper it has placed, although for only a small portion of any unsold amount of the issue. Pet. App. 4a-5a, 66a.

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[2] As of the end of April 1983, at least half of the commercial paper outstanding was placed directly by issuers. 69 Fed. Res. Bull. A26 (June 1983).

Petitioners, the Securities Industry Association ("SIA"), a securities industry trade association, and A.G. Becker, Inc., a commercial paper dealer, informally expressed concern to Board staff members regarding the legality of Bankers Trust's commercial paper activities. SIA and Becker subsequently petitioned the Board to initiate formal administrative enforcement action to restrain such activities. Pet. App. 3a, 65a.

On September 26, 1980, after considering information obtained through informal discussions with, and written submissions by, the interested parties, as well as through an on-site examination by the Board staff of Bankers Trust's commercial paper activities (Pet. App. 5a),[3] the Board denied the petitions of SIA and Becker to the extent they alleged violations of the Glass-Steagall Act or activities contrary to public policy. *Id.* at 85a. The Board issued a statement (*id.* at 65a-86a) explaining the reasons for its conclusion that the commercial paper being sold by Bankers Trust is not a security for purposes of the Glass-Steagall Act and, thus, is not subject to the Act's prohibitions against underwriting and dealing in securities.[4]

The Board first observed that Congress did not intend every instrument that could be characterized as a

[3] The staff's examination of Bankers Trust's commercial paper activities revealed that the bank places only commercial paper having the highest rating from one of the services that rate commercial paper and that the customers with which the bank places commercial paper are part of the bank's established base of institutional customers that regularly purchase other short-term obligations from it. The bank does not place the commercial paper with individuals. See Pet. App. 4a, 66a.

[4] In view of the Board's disposition of the "securities" issue, it did not reach the question whether Bankers Trust's placement of the commercial paper constituted underwriting or other activity prohibited under the Act. Pet. App. 83a. The courts below also did not reach the issue and it is not presented for resolution by this Court.

note to be a security under the Act. More specifically, it concluded that a note evidencing a transaction functionally more similar to traditional commercial banking operations than to an investment transaction was not intended to be viewed as a security under the Act. Pet. App. 74a-78a. Applying this standard to the commercial paper sold by Bankers Trust, the Board determined that such instruments represent financing transactions closer in function to commercial lending than to the sale of an investment. *Id.* at 78a-79a. The Board noted (*id.* at 78a) that historically almost all commercial paper was purchased by banks for their own accounts and thus, in essence, represented a commercial loan from a bank. The Board concluded that, although the role of banks in the commercial paper market had changed (*i.e.*, commercial banks are no longer the predominant purchasers of commercial paper), the commercial paper placed by Bankers Trust continues to have the same essential economic characteristics. Like a note evidencing a commercial loan or loan participation, the paper has very short maturities and is purchased principally by a limited number of institutions, most of whom are part of the bank's base of institutional customers that purchase short-term obligations on a regular basis, in very large denominations. *Id.* at 78a-79a.

Thereafter, the Board published a Policy Statement (the "Guidelines") containing guidelines designed to ensure that the sale of third party commercial paper by state member banks would be consistent with principles of safe banking (Pet. App. 87a-93a). The Guidelines narrowly limit the type of instruments that may be sold by providing that, among other things, a bank may place only prime quality paper, in denominations no smaller than **$100,000**, and only with financially sophisticated customers, and may not advertise any commercial paper for sale to the general public. *Id.* at 91a.[5]

[5] The Guidelines also govern the bank's credit analysis of the commercial paper issuer, the kinds of records that are to be

3. Petitioners sought judicial review of the Board's September 1980 statement that the commercial paper placed by Bankers Trust is not a security for purposes of the Glass-Steagall Act. The district court rejected the Board's conclusion that notes representing commercial transactions are not securities under the Act on the ground that any note is, ipso facto, a security. Pet. App. 39a-64a.

The court of appeals reversed. Pet. App. 1a-38a. It noted at the outset (*id.* at 7a-11a) that the district court had applied the wrong standard of review by failing to give sufficient weight to the Board's expertise. The court held that deference to the Board's interpretation is warranted in this case because of the broad scope of the Board's authority over the banking system, the Board's expert knowledge of commercial banking, the general, undefined nature of the relevant statutory terms—notes and securities, and the thorough quality of the review and the findings made by the Board and their consistency with previous rulings. *Id.* at 8a-10a.

The court of appeals did not, however, "rest merely on the deference to the conclusions of the Federal Reserve Board." Pet. App. 11a. Instead, recognizing that the courts are the final arbiters of the meaning of a statute, the court below undertook an independent analysis of the application of the Glass-Steagall Act to this case. Based on its own examination of the language of Sections 16 and 21 of the Act, the relevant legislative history and the fundamental purposes underlying the Act, the court of appeals found "essentially correct" the Board's ruling that the commercial paper placed by Bankers Trust is not a security within the meaning of the Glass-Steagall Act and that only notes of an investment character are "securities" for purposes of the Act. Pet. App. 11a-19a.

maintained, avoidance of conflicts of interest, and disclosures to purchasers. Pet. App. 91a-93a.

The court first examined the statutory language and legislative history of the Act. Pet. App. 13a-19a. Finding those sources "strongly suggest[ive]" of the notion that the placement of commercial paper is not a sale of securities for purposes of the Glass-Steagall Act (Pet. App. 17a, 19a, 22a), the court went on to analyze the functional nature of the underlying transaction at issue and concluded that it does not involve the types of hazards and dangers at which the Act is aimed. *Id.* at 22a-25a.[6] As the Board had, the court of appeals determined that the commercial paper placed by Bankers Trust has the economic characteristics of a short-term commercial loan: the default rate on commercial paper is extremely low (lower than on ordinary bank commercial loans), the maturities are very short, and the paper is placed only with sophisticated purchasers that have the resources to verify representations made by and about the issuers. *Id.* at 25a-27a. The court acknowledged that Bankers Trust is selling an obligation, rather than purchasing one, as in the case of a typical commercial loan. The court concluded, however, that the function of the bank in the transaction is not determinative, since the bank's role as seller would not result in the funds of bank depositors being tied up in speculative investments or present significant conflicts of interest, the dangers the Act was designed to prevent. *Id.* at 28a-30a.[7]

[6] The court of appeals held that the definition of a security in the federal securities laws is not determinative of the meaning of the term "securities" in the Glass-Steagall Act since the laws were enacted for fundamentally different purposes. As the court observed, the securities laws were enacted for the protection of investors, while the Glass-Steagall Act was designed to protect banks and their depositors. Pet. App. 20a-22a.

[7] The court of appeals emphasized (Pet. App. 30a-31a) that its reasoning is limited to the particular type of instrument involved in this case and that other obligations, even other types of commercial paper, such as obligations of smaller denomina-

Judge Robb dissented, concluding that if an obligation is sold (rather than purchased) by a bank, that obligation necessarily is a security for purposes of the Act. Pet. App. 31a-38a.

ARGUMENT

Petitioners challenge the standard of review employed by the court of appeals as well as the authority of the Board to issue the ruling below and the correctness of that ruling. As we show below, however, both the court of appeals and the Board applied settled principles of administrative law in ruling that the commercial paper at issue here is not a security within the meaning of the Glass-Steagall Act. Moreover, that decision is correct and does not conflict with any decision of this Court or any other court of appeals. Further review therefore is not warranted.

1. In *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981), the Court made clear that, in reviewing an agency's interpretation of a statute, the task for the court is "not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction was 'sufficiently reasonable' to be accepted by a reviewing court." The Court noted (*id.* at 37) that the breadth of the agency's authority and the thoroughness, validity and consistency of its reasoning "are factors that bear upon the amount of deference to be given an agency's ruling."

The court below faithfully applied this Court's instructions in holding (Pet. App. 8a-10a) that the Board's construction of the Glass-Steagall Act is entitled to deference in view of the Board's comprehensive authority over the nation's banking system, its expert knowledge of commercial banking, the general, unde-

tions or obligations that are distributed to the public generally, might well be securities within the meaning of the Act.

fined nature of the statutory terms at issue, the Board's thorough review and exploration of the issues and the ruling's consistency with past Board interpretations.

Moreover, the court of appeals did not "rest merely on the deference to the conclusions of the Federal Reserve Board." Rather, as described above (pages 6-7, *supra*), the court undertook its own "inquiry into the language and legislative history of the statute, and the policies underlying it." Pet. App. 11a. As a result, the court concluded (*ibid.*) that the Board's "ruling and the reasoning which supports it are essentially correct."

2. Petitioners' suggestion (Pet. 8-10) that the decision below sanctions the use of rulemaking by the Board to expand the statutory limitations on bank securities activities is unfounded.

It is evident that, in reaching the conclusion that the commercial paper at issue here is not a security within the meaning of the Glass-Steagall Act, the Board merely found that a certain statutory standard did not apply to a particular set of facts. Pet. App. 69a-83a. As the court of appeals noted (*id.* at 9a), in view of the broad, undefined nature of the language employed in the Act—"note" and "securities"—it is incumbent on the Board to identify on a case-by-case basis the particular circumstances in which these terms apply, particularly because the class of instruments covered by the statute necessarily would change as business reality in the financial markets changes.[8]

Such administrative line-drawing is inherently the function of an agency charged with the administration of a statute, especially one that contains such broad terms as "securities" and "notes." See *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 848 (1975)

[8] The court of appeals pointed out that the current situation in the commercial paper market could not have been foreseen by Congress when the Act was passed since the market has changed substantially since that time. Pet. App. 9a.

(the SEC and the federal courts must "decide which of the myriad financial transactions in our society" come within the definition of security contained in the federal securities laws); see also *Marine Bank* v. *Weaver*, 455 U.S. 551, 560 n.11 (1982) (in applying the definition of security contained in the federal securities laws, "[e]ach transaction must be analyzed and evaluated on the basis of the * * * factual setting as a whole"). Hence, rather than presenting "novel" issues of administrative authority, this case is one of the multitude of cases in which an agency has merely clarified or explained a provision in a statute or rule with whose administration it is charged.[9]

Petitioners' additional reliance (Pet. 11) on a number of recent interpretations of the Act by various financial supervisory agencies[10] also is misplaced. The subject matter of each of those rulings—the scope of permissible securities brokerage, the extent to which individual retirement trusts may be commingled, and the unique limitations applicable to securities activities of subsidiaries of banks—is wholly distinguishable from the placement of commercial paper on which the Board

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[9] Because the court of appeals sanctioned no administrative rulemaking, the fact that Congress may have withheld such authority on past occasions is of no significance. Indeed, the legislative history of the limitations placed on the Comptroller of the Currency's rulemaking authority under the Glass-Steagall Act demonstrates that Congress understood the distinction between interpreting the Act (which the court of appeals sanctioned here) and rulemaking under the Act. See S. Rep. No. 96-368, 96th Cong., 1st Sess. 13 (1979) (emphasis added) ("The Comptroller shall not use formal rulemaking authority, *as opposed to interpretive rulings* which are requested from time to time, to decide issues related to the Glass-Steagall Act".).

[10] The Comptroller of the Currency interprets Sections 16 and 21 of the Act with respect to national banks. The FDIC interprets Section 21 with respect to state chartered banks that are not members of the Federal Reserve System.

ruled in this case. Those cases are not dependent upon the disposition of this case, indeed, none of those recent opinions relies on or even cites the ruling of the Board at issue here.[11]

3 *a*. The thrust of petitioners' challenge to the merits of the decision below is that the plain language of the Glass-Steagall Act requires its application to every debt instrument that may be characterized as a note. As we show below, however, when viewed in context, the plain language of the Act, rather than advancing petitioners' argument, "strongly [supports the ruling below] that sale of commercial paper should be treated as a 'loan' rather than a sale of securities for purposes of the Act." Pet. App. 17a.

Section 16 of the Act, 12 U.S.C. (Supp. V) 24 Seventh, prohibits banks, with certain exceptions, from underwriting or dealing in "securities or stock." Significantly, this provision was added by the Glass-Steagall Act to provisions of the National Bank Act that expressly authorize a national bank to discount and negotiate "promissory notes" and "other evidences of debt." See 12 U.S.C. (Supp. V) 24 Seventh. Plainly, then, Section 16 does not prohibit bank underwriting and dealing with respect to all notes, but only with respect to those notes that qualify as "securities."[12] And the

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[11] Equally without significance is the fact that recent proposed legislation modifying the Act has not as yet been enacted. This proposed legislation is not addressed to third party commercial paper but deals instead with activities such as the underwriting of mutual funds and revenue bonds within the context of a comprehensive restructuring of the financial markets. See S. 1720, 97th Cong., 1st Sess. (1981).

[12] For the same reason, petitioners' reliance (Pet. 14) on *Investment Company Institute* v. *Camp*, 401 U.S. 617, 635 (1971) ("*ICI I*"), also is misplaced. There, the Court merely noted (*ibid.;* emphasis added) that the Act covers "*securities* representing debt," not that every debt instrument is a "security" within the meaning of the statute. To be sure, in *ICI I* the

Section provides no guidance concerning whether commercial paper is included within the statutory prohibition.

Section 21 of the Act, 12 U.S.C. 378(a)(1), which forbids banks from issuing or underwriting "stocks, bonds, debentures, notes, or other securities," also is more supportive of the Board's ruling than of petitioners' position. Although the word "notes," when viewed in isolation, may be ambiguous, when it is properly read in the context of the provision as a whole,[13] it is clear that the term was not intended to include the commercial paper at issue here.

As the court of appeals observed (Pet. App. 15a & n.46), the terms "stocks," "bonds," and "debentures" each refer to specific, well-recognized types of permanent or long-term securities. Bonds, for example, are secured debt instruments, issued under a trust indenture agreement, that are offered to the public generally in small denominations and that bear maturities of from five to 30 years. See Pet. App. 15a n.46; 1 A. Dewing, *The Financial Policy of Corporations* 171-179 (5th ed. 1953) ("Dewing").[14] Many corporations offer to the pub-

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Court also indicated (*ibid.*) that the word "securities," as used in Sections 16 and 21 of the Glass-Steagall Act, should not be narrowly construed. But in that case the Court was considering the status of equity interests in a mutual fund that operated essentially as an open-end investment company, and the Court had found "direct evidence" in the legislative history that Congress had had such ventures specifically in mind when it passed the Glass-Steagall Act. 401 U.S. at 635. By contrast, no one has identified any legislative history that suggests that the type of sale in which Bankers Trust is engaged was a practice with which the drafters of the Glass-Steagall Act were concerned.

[13] "'In expounding a statute, [this Court is not] guided by a single sentence or member of a sentence, but look[s] to the provisions of the whole law, and to its object and policy.'" *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975), quoting *United States* v. *Heirs of Boisdore*, 49 U.S. (8 How.) 113, 122 (1849).

[14] Debentures have the same characteristics as bonds except that they are unsecured. Stocks represent ownership interests in a corporation. Pet. App. 15a n.46.

lic debt instruments, referred to as "notes," that have the same characteristics as bonds or debentures, except that they bear maturities of from one to five years. *Dewing, supra*, at 178.[15] The term "note" also refers, however, to any written promise to pay a sum of money. See Pet. App. 15a & n.44; G. Munn, *Encyclopedia of Banking and Finance* 698 (7th ed. 1973). It is on this more generic usage that petitioners rely. But Congress's use of the word "notes" in conjunction with other terms that refer to specific types of long-term investment securities is strong evidence that it also intended the similar, narrower meaning of "notes" in Section 21 of the Glass-Steagall Act.[16]

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[15] As discussed below (pages 15-16, *infra*), commercial paper bears none of these characteristics.

[16] "It is a familiar principle of statutory construction that words grouped in a list should be given related meaning." *Third National Bank in Nashville* v. *Impac, Ltd.*, 432 U.S. 312, 322 (1977) (footnote omitted); see also *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) ("a word is known by the company it keeps"). The Board's interpretation thus is grounded squarely on the language of the statute, since Congress's use of words of specific meaning in Section 21 demonstrates "on the face of the statute" that the broadest possible meaning of the word "notes" was not intended. See *Jarecki* v. *G.D. Searle & Co., supra*, 367 U.S. at 307-308. In addition, if Congress had used the word "notes" in its generic sense in Section 21, there would have been no reason for it to have included "bonds" and "debentures" in the statutory litany, since those instruments are encompassed within the generic meaning of the word "note." See Pet. App. 15a-16a.

Petitioners' reliance on the definition of security in the securities laws is misplaced. While the Glass-Steagall Act refers to "notes" only in conjunction with certain specified, long-term capital obligations, the Securities Act of 1933 and Securities Exchange Act of 1934 define security to include "any note." 15 U.S.C. 77b(1) and 78c(a)(10). This difference in language demonstrates that Congress knew how to formulate a more inclusive definition than that found in the Glass-Steagall Act. More importantly, since the Glass-Steagall Act and the securities laws

b. Our reading of the statutory language (pages 11-13, *supra*) is bolstered by the functional analysis employed by the Board and the court below, whereby they concluded that the commercial paper at issue here is not the type of instrument with which the drafters of the Act were concerned.[17]

This Court has consistently recognized that the Glass-Steagall Act was designed to prohibit commercial banks from engaging in the investment banking business, not to bar them from traditional banking functions. See, *e.g.*, *Board of Governors of Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 55, 59-63 (1981) (Glass-Steagall Act would not necessarily prohibit a bank from acting as an investment adviser); see also *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971). Indeed, the legislative history of the Glass-Steagall Act makes clear that its drafters

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were enacted to accomplish different purposes, there is no basis to assume that an instrument that must be deemed a security in order to carry out the purposes of the securities laws must also be considered a security to give effect to the objectives of the Glass-Steagall Act. Compare *United Housing Foundation, Inc.* v. *Forman*, *supra*, 421 U.S. at 849 (securities laws designed to protect investors) with *Board of Governors of Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 61 (1981) ("*ICI II*") (Glass-Steagall Act designed to protect banks and depositors). In any event, despite the very broad definitions in the securities laws, not every obligation that can be characterized as a note is a security under those laws. *Marine Bank* v. *Weaver*, 455 U.S. 551, 556 (1982) (bank certificate of deposit not a security).

[17] The approach employed by the Board and the court of appeals is consistent with this Court's instruction that the determination whether a particular interest constitutes a "security" within the meaning of the federal securities laws turns on "the economic realities underlying a transaction, and not on the name appended thereto." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975). Accord, *Marine Bank* v. *Weaver*, *supra*; *Teamsters* v. *Daniel*, 439 U.S. 551, 558-559 (1979).

not only were not concerned with the sale of commercial paper but, moreover, intended the legislation to channel banking activities back into that traditional field of commercial practice. See, *e.g.*, S. Rep. No. 77, 73d Cong., 1st Sess. 4 (1933) (emphasis added) (one of the unsound practices the Act was designed to restrain was "a loose banking policy which had turned from the making of loans on *commercial paper* to the making of loans on *security*"); 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott) (emphasis added) (decrying the pre-panic trend whereby business enterprises "began to finance their requirements by the sale of their own securities *rather than by borrowing at the commercial banks upon their commercial paper—that is, upon their own notes*").[18]

Applying a functional analysis, both the Board and the court of appeals correctly concluded (Pet. App. 25a-27a, 78a-79a) that the commercial paper at issue here has all of the essential characteristics of a commercial loan. Commercial paper has a very low default rate, indeed, even lower than that of most commercial bank loans. *Id.* at 89a. Also like most commercial loans, the paper has very short maturities (30 to 90 days). See Hurley, *supra*, 63 Fed. Res. Bull. at 530; 67 Fed. Res. Bull. A26 (Dec. 1981). Finally, like commercial loans, commercial paper is purchased in very large denominations by only sophisticated purchasers such as money market mutual funds, pension funds, bank trust departments, and nonfinancial corporations with large amounts of idle cash and the resources to evaluate the creditworthiness of the issuing corporations. See Hur-

[18] See also, *e.g.*, *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess., Pt. 1, 146 (1932) (remarks of Sen. Glass); *id.* at 66-67 (remarks of Harry J. Haas, president of the American Bankers Association); 77 Cong. Rec. 3835 (1933) (remarks of Rep. Steagall).

ley, *supra*, at 529.[19] Because the commercial paper at issue here is the practical equivalent of a commercial loan, which undisputably was not a target of the Glass-Steagall Act (see pages 14-15, *supra*), it is not a "security" within the meaning of the legislation.[20]

To be sure, Bankers Trust is selling, rather than purchasing, the commercial paper at issue here. Contrary to petitioners' assertion, however, the role of the bank vis-a-vis the purchaser-lender is not dispositive.[21]

[19] Money market mutual funds alone hold more than one-third of all commercial paper outstanding. Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 333 (June 1982).

[20] Contrary to petitioners' assertion (Pet. 15), neither the holding nor the rationale of the court of appeals' opinion permits banks to underwrite short-term bonds or debentures or other types of debt instruments. In ruling as they did, both the Board and the court of appeals expressly relied (Pet. App. 25a, 27a, 79a, 91a) on each of the characteristics listed in the text above. On the other hand, the broad array of instruments commonly known as securities bears none of the qualities relied on by the court of appeals. Bonds, debentures, and investment notes entail greater risk than commercial paper, have maturities in excess of 30-90 days, and are distributed in small denominations to the public. By its express reliance on the features of the commercial paper at issue here that distinguish it from the instruments designated in the Act, the court of appeals expressly made clear that its holding does not control other debt instruments having one or more different characteristics. *Id.* at 31a.

[21] Likewise, the dissent's assertion (Pet. App. 32a) that the critical distinction between commercial banking and investment banking is the bank's role in the transaction is supported neither by the Act's provisions nor by the realities of the Nation's financial markets. For example, a text on investment banking written at approximately the time of the Act's passage states that the most common factor used in making rough practical distinctions between commercial and investment banking is that of *time*—commercial banking involving short-term advances to borrowers and investment banking involving long-term ad-

Traditional commercial banking practices also include the syndication of commercial loans, whereby banks market notes of the borrower to other lenders (see Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538 (1977)), a type of transaction to which Bankers Trust's activities here also may be analogized.[22]

In any event, the role played by Bankers Trust in this case cannot convert what would otherwise be a commercial interest into a "security" within the meaning of the Glass-Steagall Act because the bank's placement of commercial paper does not give rise to the types of risks against which that legislation was directed. See *ICI I, supra*, 401 U.S. at 630-634. In the first place, there is no danger that the bank would invest its own assets in "frozen or otherwise imprudent" investments (*id.* at 630). As noted above (page 5, *supra*), historically almost all commercial paper was purchased by banks for their own account. Moreover, the default rate on commercial paper sold in the recognized commercial paper market is far lower than the de-

vances usually represented by securities. H. Willis & J. Bogen, *Investment Banking* 6 (1936).

[22] Three courts of appeals recently have held that a loan participation is not a "security" within the meaning of the federal securities laws. See, *e.g.*, *Union Planters National Bank of Memphis* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-1185 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d 1247, 1253-1255 (7th Cir. 1980) (loan participation bore indicia of a commercial loan rather than a security); *United American Bank of Nashville* v. *Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980). Simply because the bank in this case did not commit to purchase for itself the unplaced commercial paper cannot transform the nature of the paper that is placed from a commercial loan to a "security."

fault rate on ordinary commercial loans by banks. Pet. App. 89a.[23] Hence, even if a bank placing commercial paper were forced to purchase such paper for its own account, the funds of its depositors would be subject to *less* risk of loss than if the bank has used the funds to make ordinary commercial loans.[24]

Nor would a bank be tempted to make unsound loans to facilitate the purchase of commercial paper or to shore up issuers of paper, see *ICI I, supra*, 401 U.S. at 631-632, because the nature of the market is such that commercial paper is not purchased with borrowed funds and is issued only by the financially strongest businesses. Pet. App. 89a. So also, there is no risk to the bank's good will or reputation for prudence, or any danger that the bank would give unreliable investment advice, see *ICI I, supra*, 401 U.S. at 631-632, because commercial paper is not placed with the bank's depositors generally, is issued only by highly-solvent corporations, and is held by financially sophisticated purchas-

[23] The 1970 default involving commercial paper of Penn Central, on which petitioners rely (Pet. 18), was the most recent default by a company placing paper in the recognized commercial paper market and, accordingly, constitutes an isolated case that is not representative of risk in the market. The commercial paper market has developed numerous safeguards to assure that the paper placed therein is paid at maturity. Commercial paper issuers, for example, maintain back-up lines of credit from a commercial bank that can be drawn upon to pay outstanding paper at maturity if the issuer is facing financial difficulties. Hurley, *supra*, at 530. The risk of loss on commercial paper thus is insignificant in comparison to possible losses on a commercial loan by a bank. Indeed, in 1982 alone, one large Chicago Bank suffered loan losses of more than $390 million. American Banker, Feb. 25, 1983, at 3, col. 1.

[24] Petitioners' attempt (Pet. 17) to denigrate the importance of the low-risk nature of the commercial paper at issue here also cannot succeed. As *ICI I* makes clear (401 U.S. at 634-639), risk is one factor in the determination whether a particular instrument is a security.

ers that have the resources to make their own judgment concerning the risk of purchase. Pet. App. 89a-90a.[25]

Finally, the mere existence of a promotional interest or the earning of income through a fee is not, as petitioners suggest (Pet. 16-17), one of the evils against which the Act was directed; otherwise the Act would prohibit a bank from providing traditional banking services, such as selling its own deposit instruments or providing investment advice (see *ICI II*, *supra*, 450 U.S. at 55-56), which also involve promotional interest and fee income. Rather, the Act plainly was designed to proscribe only those promotional incentives that are inherent in the *securities* markets.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

J. PAUL MCGRATH
Assistant Attorney General

ANTHONY S. STEINMEYER
Attorney

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel
Board of Governors of the Federal Reserve System

JULY 1983

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[25] Petitioners' challenge (Pet. 17) to the Guidelines issued by the Board (Pet. App. 87a-93a) is without merit, since the Board found the commercial paper at issue here outside the purview of the Act. Hence, the Guidelines simply assure that banks do not engage in transactions covered by the Act and do not violate safe banking principles.

No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

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Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

A.G. BECKER INCORPORATED,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

BRIEF OF *AMICUS CURIAE* BANKERS TRUST COMPANY IN SUPPORT OF RESPONDENTS

JOHN W. BARNUM
(Counsel of Record)
JENNIFER A. SULLIVAN
W. MICHAEL TUPMAN
WHITE & CASE
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 872-0013
Attorneys for Amicus Curiae Bankers Trust Company

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BRIEF OF *AMICUS CURIAE* BANKERS TRUST COMPANY IN SUPPORT OF RESPONDENTS

INTEREST OF THE *AMICUS CURIAE*

This brief *amicus curiae* is filed with the written consent of all parties on behalf of Bankers Trust Company ("Bankers Trust").[1] Bankers Trust is a New York State-

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[1] *See* Letter dated June 14, 1983 from Harvey L. Pitt to Jennifer Sullivan, Letter dated June 15, 1983 from James B. Weidner to the Clerk of the Supreme Court of the United States, and Letter dated

chartered member bank of the Federal Reserve System with headquarters in New York City. Bankers Trust participates as agent in the sale of commercial paper by certain corporations not affiliated with Bankers Trust. The September 26, 1980 statement by the Board of Governors of the Federal Reserve System ("the Board") regarding Bankers Trust's commercial paper service is the subject of the instant litigation. Bankers Trust thus has a clear interest in this case.

Bankers Trust participated extensively in the proceedings before the Board, in the district court, where it filed three memoranda of law *amicus curiae*, and in the Court of Appeals, where it filed two briefs *amicus curiae*. Consequently, the continued participation of Bankers Trust as *amicus curiae* will aid the fullest possible development of all available information pertaining to the issues in this case.

REASONS FOR DENYING THE WRIT

I. The Decision Of The Court Of Appeals Does Not Raise Any Issue Of "National Significance."

After nearly two years of exhaustive inquiry and study, including an on-site examination at Bankers Trust and analysis of the role of commercial paper[2] as a credit instrument in the nation's financial system, the Board concluded that Congress did not intend to prohibit com-

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June 16, 1983 from the Solicitor General to Craig Alan Wilson, filed with this Brief.

[2] As stated by the Court of Appeals, the term commercial paper "refers to prime quality, negotiable promissory notes bearing very short maturities" issued by "[l]arge, financially strong corporations . . . to obtain funds for current needs." (4a. Citations in this form refer to pages of petitioners' Appendix.)

mercial banks from selling prime quality commercial paper in large denominations to financially sophisticated customers.[3]

Petitioners solemnly proclaim that the decision of the Court of Appeals upholding the Board "raises important issues of national significance." Petition at 8. That decision may have significance for petitioners themselves, but the significance to them is *competition*. In enacting Glass-Steagall, however, Congress never intended to limit competition, divide markets, or otherwise protect securities firms.[4] Congress intended the Glass-Steagall Act to prevent hazards that potentially arise when commercial banks engage in activities involving certain speculative securities.

The hazards that are the concern of Glass-Steagall are not present in Bankers Trust's commercial paper service. As correctly determined by the Board and the Court of Appeals, the commercial paper sold by Bankers Trust is functionally similar to traditional lending instruments. In addition Bankers Trust's role in the sale of commercial paper is similar to arranging the extension of a short-term loan by a "few sophisticated lenders to financially strong purchasers." (7a.) The institutional purchasers of the

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[3] Federal Reserve System, Statement Regarding Petitions to Initiate Enforcement Action (Sept. 26, 1980) ("Board Statement") (65a-86a).

[4] "Neither the language of the pertinent provisions of the Glass-Steagall Act nor the legislative history evinces any congressional concern for . . . freedom from competition." *Investment Co. Institute v. Camp*, 401 U.S. 617 (1970) [hereinafter cited as *ICI(1)*], at 640 (Harlan, J., dissenting on the issue of petitioners' standing). *See* H. Angermeuller, *Commercial vs. Investment Bankers*, Harv. Bus. Rev. 132, 134 (Sept.-Oct. 1977).

commercial paper are the same class of purchasers to which banks sell other commercial credit instruments such as certificates of deposit and bankers' acceptances. (27a.) Consequently Bankers Trust's commercial paper activities are functionally equivalent to the "traditional lending functions of commercial banks." (25a.)

Bankers Trust here addresses each of the three issues of "national significance" that petitioners claim are raised by the decision of the Court of Appeals.

A. The Court of Appeals expressly limited its holding.

Petitioners overstate the effect of the decision of the Court of Appeals. Petition at 8. The Court of Appeals held "that commercial banks may sell third party commercial paper provided that they comply with the Board's Guidelines" (30a-31a), and therefore its holding is expressly limited to instruments defined by the Board's Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks:[5] "prime quality commercial paper, of a maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public." (30a.) Furthermore the Court of Appeals expressly limited its holding to bank sales of such instruments in a manner complying with the Guidelines. (31a.) Finally, neither the Board nor the Court of Appeals determined or were ever required to determine whether Bankers Trust's placement of commercial paper constitutes "underwriting" as defined for purposes of the Glass-Steagall Act; having

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[5] The Board's Policy Statement (87a-93a) is hereinafter referred to as "the Guidelines."

decided that the commercial paper Bankers Trust sold was not a "security" for purposes of Glass-Steagall, neither reached that issue. Petitioners' references to underwriting therefore are misleading. (31a.)

B. The Board exercised its lawful function to construe and enforce the Glass-Steagall Act.

The threshold issue that has been dispositive in this litigation is whether commercial paper constitutes a "security" for purposes of the Glass-Steagall Act. Congress did not define the term "security" in the act, but has charged the Board with " 'primary and substantial responsibility for administering' federal regulation of the national banking system." (8a.)[6] In exercising this responsibility the Board was called upon to consider first whether the commercial paper sold by Bankers Trust is even a "security" under the act.

Petitioners contend that the Glass-Steagall Act contains "flat prohibitions" and that the Board has improperly taken a regulatory approach to enforcing the act, considering on a "case-by-case" basis whether a particular bank activity is prohibited. Petition at 8-9. These contentions are meritless. By not defining the term "securities" in the act Congress necessarily envisioned that the Board would have to engage in a functional analysis to determine whether a particular instrument is a "security" for

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[6] Quoting *Federal Election Comm'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 37 (1982). *See Board of Governors of the Fed. Reserve Sys. v. Agnew*, 329 U.S. 441, 450 (1947) ("Congress has committed the [federal banking] system's operation to their hands . . . because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all its phases") (Rutledge, J., concurring).

Glass-Steagall purposes.[7] In fact, since the enactment of Glass-Steagall the Board has been called upon many times to determine whether a particular kind of note constitutes a "security" for purposes of the act.[8] Where the Board has previously exercised its authority in a

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[7] Even under the federal securities laws, with their elaborate definition of a "security," the Securities and Exchange Commission and the courts have long found it necessary to proceed on a case-by-case basis to determine if an instrument is a "security" for purposes of those laws. As recently held by this Court in determining that certificates of deposit are not "securities" for purposes of the Securities Act of 1933 ("Securities Act"): "Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." *Marine Bank* v. *Weaver*, 455 U.S. 551, 560 n.11 (1982).

[8] *E.g.*, Letter dated June 8, 1934 from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of New York (bankers' acceptances are not "securities" for purposes of the Glass-Steagall Act); Letter dated July 13, 1934 from the Secretary of the Board to the Federal Reserve Agent, Federal Reserve Bank of Richmond (notes secured by direct deeds of trust on real estate are not "securities" for purposes of the act); 12 C.F.R. § 218.109 (regulation issued December 2, 1964) (short-term unsecured negotiable notes of the kind issued by some large banks to obtain funds are not "securities" for purposes of the act); Letter dated March 6, 1974 from the Secretary of the Board to the Administrator, Small Business Administration (notes representing portions of loans by nonbank lenders guaranteed by the Small Business Administration are not "securities" for purposes of the act).

Similarly, pursuant to its authority to interpret and enforce the act with regard to national banks, the Office of the Comptroller of the Currency has long construed the undefined term "securities" as not including notes like commercial paper. *See* Letter dated Nov. 19, 1971 from the Chief Counsel, Office of the Comptroller of the Currency, to First National Bank of Minneapolis. Petitioners' characterization of the Board Statement as an "unprecedented" administrative ruling (Petition at 4 n.3) is therefore inaccurate.

certain manner, and Congress has not disturbed that action, the propriety of the Board's action "is entitled to great respect."[9]

Petitioners argue that Congress has rejected the Board's exercise of authority in this manner, both in 1935 and in recent legislation regarding financial services. Petition at 9-10. The proposal in 1935 to amend the McFadden Act to permit national banks to underwrite "investment securities" is not germane because Congress did not consider commercial paper to be an "investment security."[10] The proposal therefore would not have affected the legality of bank activities involving commercial paper. Furthermore, although recent legislation does not explicitly authorize commercial banks to sell commercial paper in compliance with the Guidelines, Congress has not given any indication that it disapproves the Board Statement or Guidelines. The legislation cited by petitioners (Petition at 10 n.7) does not narrow the Board's regulatory authority in this area, but rather focuses on broad issues concerning regulation of the financial services industry. A more reasonable inference from this legislation is that Congress is satisfied with the manner in which the Board is carrying out its responsibilities.[11]

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[9] *Board of Governors of the Fed. Reserve Sys.* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248 (1978).

[10] The McFadden Act, ch. 191, 44 Stat. 1226 (1927), authorizes national banks to purchase "investment securities," defined to mean, *inter alia*, "bonds, notes, and/or debentures commonly known as investment securities." 12 U.S.C. § 24. The 1935 proposal would have authorized national banks not only to purchase but also to underwrite "investment securities." As noted by the Court of Appeals, however, the legislative history of the McFadden Act makes clear that Congress did not consider commercial paper to be an "investment security." (19a & n.59.)

[11] Petitioners suggest that Congress indicated disapproval of and limited the exercise of regulatory authority by federal banking agen-

Petitioners try to elevate the importance of their disagreement with the Board Statement to "national significance" by arguing that the Statement is but one of many concerted attempts by "federal banking agencies . . . to dismantle the Glass-Steagall Act through 'administrative interpretation.' " Petition at 11. The decision of the Court of Appeals, petitioners contend, sends a signal not only to the Board but to other federal agencies to continue authorizing new banking services, thus prompting further court challenges by the securities industry. Petition at 8, 12.

The lawfulness of actions taken by federal agencies other than the Board, or of any Board action other than its Statement regarding commercial paper, is not at issue in this litigation and petitioners should not be able to bootstrap other agency actions to justify review of the instant case.[12] Moreover it is inappropriate for petitioners to threaten to expand "the caseload of the federal judiciary" (Petition at 8) by challenging those other agency actions in order to justify this Court's review of the instant case.

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cies when it stated that the Comptroller of the Currency does not have substantive rule-making authority under the Glass-Steagall Act to regulate securities activities of national banks. Petition at 10, *citing* 12 U.S.C. § 93a. This inference is strained at best. Congress simply wanted to make "clear that the rule-making provision [clarifying that the Comptroller has authority to prohibit unsafe or unsound banking practices] carries no authority to permit otherwise impermissible activities of national banks. . . ." Joint Explanatory Statement of the Committee of Conference, H.R. Rep. No. 842, 96th Cong., 2d Sess. 83 (1980). Moreover Congress explicitly recognized the authority of the Comptroller to make "interpretive rulings which may be requested from time to time, to decide issues related to the Glass-Steagall Act." S. Rep. No. 368, 96th Cong., 1st Sess. 13 (1979).

[12] Although the lawfulness of other agency actions is not at issue in this litigation, Bankers Trust is compelled to point out that petitioners have grossly mischaracterized the rulings by those agencies. In

In support of their arguments petitioners recite a variety of services that commercial banks have been authorized to offer in recent years, claiming that these services were understood for nearly 50 years "to be barred to banks." Petition at 11. That a banking service may be relatively new does not in itself give rise to any intimation of unlawfulness. The ever-changing demands of the marketplace engender innovations in banking and, as the Court of Appeals recognized, the federal banking laws must be allowed to adapt "to the changing needs of our economy." (9a n.25.)[13]

Just as the banking industry has sought to develop new products and services to meet the demands of the marketplace, so securities firms have sought to acquire banking institutions and provide services resembling traditional bank services. For example:

—many securities firms now operate money market funds, which are functionally similar to bank deposits;[14]

—securities firms have recently begun to market the depository accounts and certificates of deposit of

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exercising its lawful regulatory function to interpret and enforce the federal banking laws, each of those agencies thoroughly considered the implications of the activities in question under the Glass-Steagall Act and in light of prior decisions of this Court.

[13] *See M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) (bank laws must be construed to permit "use of new ways of conducting the very old business of banking").

[14] As with bank deposits, money can be withdrawn from a money market fund on demand by using drafts. Thus, "in a very real sense an account in a money market fund is more like a bank account than a traditional investment in securities." *Gartenberg* v. *Merrill Lynch Asset Management, Inc.*, 528 F. Supp. 1038, 1068 (S.D.N.Y. 1981), *aff'd*, 694 F.2d 923 (2d. Cir. 1982).

commercial banks and savings and loan associations, thereby gaining access to a broad base of deposits;[15] and

—securities firms are entering the banking business directly by obtaining state and national bank charters or by acquiring existing commercial banks or savings and loans. In this way securities firms are beginning to compete directly with commercial banks in offering such commercial banking services as IRA and Keogh retirement accounts, credit cards, checking accounts, and personal loans.[16]

It is disingenuous for petitioners to argue on the one hand that the Glass-Steagall Act "flatly" prohibits new services offered by banks, thus foreclosing any flexible response by bank regulators like the Board, while on the other hand securities firms entreat federal bank regulators for authorization and have obtained authorization to

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[15] *See, e.g.*, "Merrill, Fidelity Will Sell All-Savers Offered by Thrifts, Plans May Be Trend of Cooperative Marketing," *American Banker*, Sept. 29, 1981, at 1; "In a Wall Street 'First,' Merrill Selling CDs for Retail Investors," *Securities Week*, June 14, 1982, at 1.

[16] For example, the Dreyfus Corporation, which manages and controls a group of mutual funds, received approval from the Comptroller of the Currency on February 4, 1983 to charter a national bank (Dreyfus National Bank). [Current] Fed. Banking L. Rep. (CCH) ¶ 99,528, at 86,726. In addition Dreyfus has purchased a New Jersey state bank and has agreed to buy Metropolitan Savings & Loan Association, Inc. "Dreyfus Sees Lincoln State as Ideal Acquisition," *American Banker*, Nov. 23, 1982, at 2; "Dreyfus Awaits Word on Bid for Thrift," *American Banker*, Jan. 19, 1983, at 1. Further, Merrill Lynch & Co. has agreed to buy Raritan Valley Financial Corp., the owner of Raritan Valley Savings & Loan Association, *American Banker*, Apr. 28, 1983, at 1, and the Fidelity Group has applied for a state banking charter in New Hampshire. "Fidelity Group's Proposal to Start a Bank in New Hampshire Is Attacked as Unfair," *The Wall Street Journal*, Nov. 8, 1982, at 4.

perform services traditionally offered only by commercial banks.

C. The Court of Appeals properly accorded deference to the Board.

Petitioners argue that the Court of Appeals accorded "undue deference" to the Board's interpretation of the Glass-Steagall Act, thus encouraging the Board to exceed the scope of its regulatory authority. Petition at 12-13. The Board, having "primary and substantial responsibility" for enforcing the act, was required to construe the undefined term "securities" in order to determine whether Bankers Trust's commercial paper service was lawful under the act. (8a-9a.) To this end the Board, with its "expert knowledge of commercial banking," devoted nearly two years of legal and factual study. (8a, 10a.) Any deference by the Court of Appeals therefore could only encourage the Board to perform its lawful regulatory function as intended by Congress.

Furthermore the Court of Appeals did not accord "undue" deference to the Board, thereby abdicating its judicial "responsibility." Petition at 13. To the contrary the Court of Appeals expressly stated: "We do not, however, rest merely on the deference to the conclusions of the Federal Reserve Board." (11a.) The Court of Appeals engaged in its own, separate "analysis of the application of the Glass-Steagall Act to the present case" (*id.*) and as a result concluded that the Board's interpretation of the act was reasonable.

Petitioners argue that any deference at all is "pointless" where an administrative agency "sanctions an activity that violates plain statutory language." Petition at 12

n. 14.[17] The Court of Appeals, however, concluded that the Board's interpretation of the Glass-Steagall Act comported with both the plain language of the act and congressional purposes. Consequently consideration of the degree of deference was not only appropriate but prescribed by this Court.

In applying the correct standard of review the Court of Appeals did not interpret the Glass-Steagall Act "as it thought best," but rather inquired into whether the Board's construction of the act was " 'sufficiently reasonable' to be accepted by a reviewing court." (8a, *quoting* 454 U.S. at 39.) In addition the Court of Appeals considered the special deference this Court has consistently shown to the Board. (9a & n.22.) This Court has emphasized that "[o]ur obligation to accord deference to the

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[17] In support, petitioners cite *Federal Election Comm'n* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27 (1981). In that case the Court held that deference to the Commission's statutory construction was warranted, but stated that any discussion of the degree of deference would be unnecessary if a court determined that an agency's statutory construction violated the plain language of the statute as well as congressional purposes. *Id.* at 31. In the other cases cited by petitioners the Court held that deference to a particular agency was not warranted only because the agency's interpretation of a statute was wholly unsupported (unlike the instant case). *See Espinoza* v. *Farah Mfg. Co.*, 414 U.S. 86, 94-95 (1973) (there were "compelling indications" that the agency's interpretation was wrong); *Zuber* v. *Allen*, 396 U.S. 168, 193 (1969) ("[t]hose props that serve to support a disputable administrative construction are absent"); *American Ship Bldg. Co.* v. *NLRB*, 380 U.S. 300, 318 (1965) (there was no "fair construction" of the statute to support the agency's determination). *Barlow* v. *Collins*, 397 U.S. 159 (1970), also cited by petitioners, is inapposite. That case did not involve the appropriate standard of review, but rather whether Congress, by statute, intended to preclude judicial review of administrative action.

Board's interpretive ruling" is particularly strong where the Board has expressly articulated its position and provided "guidance as to the effect of the Glass-Steagall Act on the proposed activity." *Board of Governors of the Federal Reserve System* v. *Investment Co. Institute*, 450 U.S. 46 (1981) [hereinafter cited as *ICI(2)*], at 68.[18] Because the Board Statement and Guidelines fully "recogniz[e] and addres[s] the concerns that led to the enactment of the Glass-Steagall Act" (*id.*), the Court of Appeals properly accorded a degree of deference to the Board.

II. The Decision Of The Court Of Appeals Does Not Conflict With Prior Decisions Of This Court.

A. The plain language of the Glass-Steagall Act does not prohibit banks from selling notes in the nature of a loan like commercial paper.

This Court has never considered the issue of whether commercial paper constitutes a "security" for purposes of the Glass-Steagall Act. Nor has this Court ever had occasion to construe the term "notes" as used in Section 21 of the act. Petitioners nevertheless contend that the decision of the Court of Appeals "conflicts with controlling decisions of this Court" by ignoring the "plain language"

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[18] *See Board of Governors of the Fed. Reserve Sys.* v. *First Lincolnwood Corp.*, 439 U.S. 234, 248 (1978); *Board of Governors of the Fed. Reserve Sys.* v. *Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., concurring). Petitioners suggest that the degree of deference accorded an agency depends upon whether the issues are "purely legal in nature." Petition at 12. All three cases cited above, however, involved legal issues of statutory construction, like the instant case. Moreover the Board's statutory construction in the instant case was premised in part on a comprehensive factual inquiry of Bankers Trust's commercial paper service and the function of commercial paper as a credit instrument in the nation's financial system.

of the act and giving the term "notes" a "narrower meaning" than intended by Congress. Petition at 13-15.

It is petitioners who ignore the plain language of the Glass-Steagall Act by construing the single term "notes" in isolation and completely out of context. Petitioners thus fail to heed this Court's instruction that a word in a statute "does not stand alone, but gathers meaning from the words around it."[19] The Court of Appeals properly construed the term "notes" by reference to its companion words: "stocks, bonds, debentures . . . or other securities." The specific inclusion of these other terms evidences congressional intent to include only notes in the nature of a security (*i.e.*, investment notes) within the limitations of the Glass-Steagall Act, not short-term notes in the nature of a loan such as commercial paper. (16a-17a.)

Moreover, to construe the single term "notes" in isolation to mean all notes, as petitioners do, would prohibit commercial banks from engaging in unquestioned and unquestionably lawful activities involving notes such as issuing certificates of deposit, dealing in bankers' acceptances, purchasing commercial paper for their own account, and selling loan participations. (16a n.48.) Such an unreasonable result clearly was not intended by Congress.[20]

Petitioners point out that Congress defined a "security" in the Securities Act to mean, *inter alia*, "any note"

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[19] *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961). *Accord Third Nat'l Bank in Nashville* v. *IMPAC, Ltd.*, 432 U.S. 312, 322 (1977) (application of this principle to a federal banking statute).

[20] Apparently to mitigate the unreasonable results of their construction petitioners, without support or explanation, have throughout their petition (*e.g.*, at i, 5-6, 15) inserted the modifier "corporate"

(15 U.S.C. § 77b(1)) and rejected a proposal to exclude commercial paper from this definition, thereby evidencing that Congress knew how to limit the term "notes" in a statute when it wanted. Petition at 14 n.16.[21] In fact Congress did limit the term "notes" in Section 21 of the Glass-Steagall Act by including the companion words "stocks, bonds, debentures . . . or other securities." Moreover, as correctly determined by the Court of Appeals, the definition of "security" in the Securities Act does not apply to the Glass-Steagall Act because the two acts involve different subject matter and purposes. (20a-22a.) Indeed, this Court's recent interpretations of the Glass-Steagall Act "make no reference at all to the securities laws." (20a n.63.) Petitioners do not contend that the decision of the Court of Appeals not to apply the Securities Act definition of "security" to the Glass-Steagall Act was incorrect or in conflict with prior decisions of this Court.

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before the term "notes," thereby undercutting their entire plain language argument that the act prohibits the underwriting of *all* notes.

Petitioners claim that it is the Court of Appeals' construction that leads to unreasonable results by "implicitly" permitting banks to underwrite such instruments as short-term bonds and debentures. Petition at 15. But the Court of Appeals expressly and carefully limited its holding to the type of commercial paper specified in the Board's Guidelines. (30a.)

[21] Congress did, however, exempt commercial paper from the registration, though not the antifraud, provisions of the Securities Act. The Public Utility Holding Company Act of 1935, which petitioners cite together with the Securities Act, also defines a "security" to mean, *inter alia*, "any note," and hence also has an express exemption for commercial paper. 15 U.S.C. §§ 79b(a)(16), 79i(c)(3). Moreover petitioners fail to mention that commercial paper is excluded from the definition of "security" in the Securities Exchange Act of 1934. 15 U.S.C. § 78c(a)(10).

Finally, petitioners argue that this Court has indicated that the term "securities" as used in the Glass-Steagall Act should be construed broadly, and hence that any construction limiting the scope of the term (*i.è.*, by excluding notes like commercial paper) contravenes the holding in *ICI(1)*. Petition at 14.[22] In fact this Court held in *ICI(1)* that the term "securities" could not be construed so narrowly as to exclude participating interests in an open-end mutual fund. 401 U.S. at 635. While this Court stated that the term "securities" was broad enough to encompass both equity and debt securities, it does not follow from this statement that the term should be given so broad a definition that it would encompass traditional commercial credit instruments, including notes such as bankers' acceptances, certificates of deposit, and commercial paper.

In sum, the decision of the Court of Appeals comports with the plain language of the Glass-Steagall Act and the prior decisions of this Court.

B. Bankers Trust's commercial paper service does not give rise to potential hazards.

Petitioners also argue that the decision of the Court of Appeals violates congressional purposes in enacting Glass-Steagall. One of those purposes was to prevent

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[22] In addition to *ICI(1)* petitioners cite three other cases in support of this argument. Petition at 14 n.15. In *ICI(2)* this Court did not discuss whether a broad or narrow construction of the act was more proper. In the other two cases, *Board of Governors of the Fed. Reserve Sys.* v. *Agnew*, 329 U.S. 441 (1947), and *Awotin* v. *Atlas Exchange Nat'l Bank*, 295 U.S. 209 (1935), construction of the term "securities" in the act was not at issue. Indeed, *Awotin* did not even involve the Glass-Steagall Act, but rather the McFadden Act, as originally enacted by Congress six years prior to Glass-Steagall.

hazards that potentially arise when a bank engages in certain speculative securities activities. Petitioners contend that the decision of the Court of Appeals did not fully account for these potential hazards and thus conflicts with this Court's decision in *ICI(1)*. Petition at 16-18. It is clear from its opinion, however, that the Court of Appeals considered all of the potential hazards discussed by this Court in *ICI(1)* and found that a bank's sale of commercial paper in compliance with the Guidelines does not give rise to any of those hazards. (22a-30a.)

Petitioners contend that the Court of Appeals focused only upon "the characteristics of the instruments involved," thereby overlooking the hazards that may arise as a result of the bank's role in the transaction. Petition at 16. In fact the Court of Appeals thoroughly analyzed the bank's role in selling commercial paper and concluded: "The bank's role as seller does not threaten the bank with those dangers which the Glass-Steagall Act was designed to prevent." (28a.)

In their discussion of "potential hazards," petitioners can name only the bank's potential conflict of interest in promoting the sale of commercial paper. Petition at 16. After considering this point at length the Court of Appeals correctly concluded that there was no potential conflict of interest because: (1) the bank cannot use its credit facilities to extend credit to potential purchasers of commercial paper; (2) the bank is not in a position to abuse its reputation for prudence or give unreliable financial advice to its depositors in order to promote the sale of commercial paper; and (3) the bank's reputation for prudence will not suffer by its association with the issue of commercial paper. (28a-30a.) Thus petitioners' incantation of potential "hazards" is simply contrary to the facts and to the administrative record compiled by the Board.

Petitioners refer to the Guidelines as indicative of the Board's own recognition that "hazards" potentially exist. Petition at 17. The Guidelines were issued pursuant to the Board's authority "to restrain unsafe or unsound banking practices by State member banks" (18 U.S.C. § 1818) and thus address more general concerns of banking regulation than the specific kinds of hazards that are the concern of Glass-Steagall. Moreover this Court has encouraged the use of guidelines by the Board in promoting the aims of Glass-Steagall. In *ICI(2)* this Court noted that the restrictions on bank investment adviser services in the Board's interpretive ruling "avoided the potential hazards involved in any association between a bank affiliate and a closed-end investment company." 450 U.S. at 68. Similarly the Board's commercial paper Guidelines are in part designed to avoid any potential hazards that otherwise might be involved in the sale of commercial paper.

Petitioners argue that the Guidelines only "minimize," but do not eliminate, potential hazards because those hazards are "*inherent* in the combination of investment and commercial banking." Petition at 17.[23] This argument

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[23] As an example petitioners point to the 1970 default by Penn Central on its commercial paper notes, which were marketed by Goldman, Sachs & Co., a member of petitioner Securities Industry Association, as "prime" quality commercial paper only weeks before the default. Petition at 18. The sale of commercial paper, like many other traditional commercial banking activities including bank loans, obviously is not completely risk free. As recognized by the Court of Appeals, however, "the default rate on commercial paper is much lower than that on ordinary commercial loans made to high-grade commercial customers." (25a-26a & n.79.) Moreover the Penn Central case is an example of a breakdown in the corporate disclosure system; it no more demonstrates that commercial paper is inherently a speculative instrument than the financial accounting and disclosure

is based on a fundamental misunderstanding of the Glass-Steagall Act: that it mandates a "complete separation" of activities performed by commercial banks and securities firms. Petition at 12. This Court has recognized, however, that although the act "prohibits" a securities firm from engaging in the commercial banking business, the act only "places a limit on the power of a bank to engage in securities transactions." *ICI(2)*, 450 U.S. at 62. Thus, whether a securities firm engages in a particular activity (*e.g.*, selling commercial paper) does not necessarily mean that a commercial bank cannot lawfully do the same.

Indeed there are a number and variety of lawful intersections between the activities of commercial banks and securities firms. As noted by the United States Department of Justice in recent hearings before Congress:

> Within the limitations imposed by the Glass-Steagall Act, banks have offered automatic investment plans for the purchase of securities, dividend reinvestment plans, and a variety of financial services, including commercial paper and private placement services, to corporate and governmental clients.[24]

The question then is not whether a commercial bank competes with a securities firm in offering a particular

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problems experienced in 1975 by New York City are proof that municipal securities are speculative instruments. *See* Securities and Exchange Commission Staff Report on the Financial Collapse of the Penn Central Company (Aug. 1972); Final Report in the Matter of Transactions in the Securities of the City of New York, Securities Exchange Act Release No. 13547 at III and Appendix at Ch. 2, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,936 (1979).

[24] Testimony (at 5) of William F. Baxter, Assistant Attorney General, Antitrust Division, United States Department of Justice, on July 8, 1981 before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary in hearings regard-

service, but whether the commercial bank thereby runs the risk of potential hazards that Congress intended Glass-Steagall to prevent. The Court of Appeals correctly determined that a bank's acting as agent in the sale of commercial paper in compliance with the Guidelines does not give rise to any such hazards.

CONCLUSION

For the foregoing reasons the joint petition for writ of certiorari should be denied.

Respectfully submitted,

JOHN W. BARNUM
(Counsel of Record)
JENNIFER A. SULLIVAN
W. MICHAEL TUPMAN
WHITE & CASE
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 872-0013
Attorneys for Amicus Curiae
Bankers Trust Company

June 30, 1983

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ing the structure of the financial services industry. (A copy of Mr. Baxter's testimony from these as-yet-unpublished hearings was appended to the *amicus curiae* brief filed by Bankers Trust with the Court of Appeals on January 22, 1982.) *See also* D. Ratner, "Deregulation of the Intersection of the Banking and Securities Industries," *The Deregulation of the Banking and Securities Industries* 326 (1979).

No. 82-1766

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Respondents.

A. G. BECKER INCORPORATED,
Petitioner,

—v.—

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, et al.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF IN SUPPORT OF JOINT PETITION FOR WRIT OF CERTIORARI

Harvey L. Pitt
(Counsel of Record)
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
600 New Hampshire Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner A. G. Becker Incorporated

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner Securities Industry Association

[Counsel continued on inside cover]

Of Counsel:

Steven M. Looney
General Counsel
A. G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

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Respondents' Brief in Opposition confirms that the Joint Petition for Certiorari should be granted.

First, Respondents claim that the numerous other proceedings before financial supervisory agencies cited by Petitioners are "not dependent upon the disposition of this case" and do not "rel[y] on or even cit[e]" the ruling at issue here. (Resp. Br. at 10-11.) Actually, the Federal Deposit Insurance Corporation, to mention just one example, specifically cited the ruling here at issue and the "functional analysis" it adopts, in proposing to authorize new and far-ranging securities under-

writing activities by the 9,000 banks under its jurisdiction (*see* 48 Fed. Reg. 22155)—a proposal that the Chairman of the Securities and Exchange Commission has testified "does violence to the intent of the Glass-Steagall Act." *Daily Executive Report* (BNA), No. 111 at A-17 (June 8, 1983). There simply can be no doubt about the broad impact and importance of the Board's unprecedented action.[1] (*See* Joint Petition 8-12.)

Second, Respondents assert that the Glass-Steagall Act contains ambiguous terms (Resp. Br. at 9), an assertion that flies in the face of half a century of consistent understanding by the commercial banking industry that the plain language of the Act prohibits bank underwriting of commercial paper notes.[2]

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1 Also, in *Securities Industry Ass'n* v. *Federal Reserve Board*, No. 83-4019, slip op. (2d Cir., July 15, 1983) the Second Circuit cited the majority opinion below in deferring to the Board's decision to allow bank holding companies to own discount brokerage subsidiaries, for the first time in half a century. The Comptroller of the Currency, too, is now relying heavily on the ruling here at issue to justify his unprecedented decision to permit national banks to operate mutual funds made up of individial retirement account assets and to distribute shares in the fund to the public in direct contravention of this Court's ruling in *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971). *See Investment Co. Institute* v. *Conover*, Civil Action No. 83-0549 (D.D.C.), Defendant's Memorandum of Points and Authorities in Support of Their Motion for Summary Judgment (filed May 6, 1983). And, the Comptroller is also relying on the decision here in attempting to justify his approval of national banks' operating discount brokerage businesses in *Securities Industry Ass'n* v. *Conover*, Civil Action No. 82-2865 (D.D.C.).

2 For nearly fifty years since the Glass-Steagall Act was passed banks refrained from even attempting to underwrite commercial paper notes, reflecting, as this Court stated in *BankAmerica Corp.* v. *U.S.*, 51 U.S.L.W. 4685, 4688 (June 8, 1983), "what was universally perceived as plain statutory language" and indicating that Congress intended the Act "to be interpreted according to its plain meaning."

(Joint Petition at 14-15.) Indeed, by claiming ambiguity in the plain language of the Act and then construing its terms narrowly, Respondents continue squarely to contradict controlling precedent of this Court, both as to proper construction of expansive statutory language generally (*Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 588-9 (1980)) and of the Glass-Steagall Act specifically (*Investment Co. Institute* v. *Camp*, 401 U.S. 617, 635 (1971)).

Third, Respondents argue that the Board "merely found that a certain statutory standard did not apply to a particular set of facts." (Resp. Br. at 9.) Yet, the Brief in Opposition itself concedes the complex regulatory scheme adopted, under a statute that authorizes none. (Resp. Br. at 5.) Indeed, Respondents seek to justify the ruling, not upon the language of the statute itself, but upon policy arguments and alleged "business reality" (Resp. Br. at 9), again confirming the increasing tendency of bank regulators to side-step statutory restrictions that do not suit their policy objectives. (Joint Petition at 11-12.) As this Court only recently reaffirmed, however, policy determinations "must be implemented by Congress, and not by a crabbed interpretation of the words of the statute." *BankAmerica Corp.* v. *U.S.*, *supra*. Here, Congress has steadfastly refused to relax the Act's prohibitions (Joint Petition at 10), underscoring the importance of this Court's review of this case.

CONCLUSION

For the reasons set for above and in the Joint Petition for Certiorari, this Court should issue a Writ of Certiorari to review the judgment and opinions of the court below.

Dated: August 12, 1983

Respectfully submitted,

Harvey L. Pitt
(Counsel of Record)
Henry A. Hubschman
David M. Miles
FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
600 New Hampshire
Avenue, N.W.
Suite 1000
Washington, D.C. 20037
(202) 342-3500
Attorneys for Petitioner
A. G. Becker Incorporated

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner
Securities Industry
Association

Of Counsel:

Steven M. Looney
General Counsel
A. G. Becker Incorporated
55 Water Street
New York, New York 10041
(212) 747-4025

Of Counsel:

William J. Fitzpatrick
Securities Industry
Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry
Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

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Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner Securities Industry Association

QUESTIONS PRESENTED

At issue is an unprecedented administrative construction of the Glass-Steagall Act, the primary federal statute that has governed the structure of the financial services industry in this country since the national banking crisis fifty years ago. The specific questions presented are:

1. Did the majority below err in acceding to a ruling of the Federal Reserve Board that allows banks to underwrite commercial paper, despite the express prohibition in the Glass-Steagall Act against bank underwriting of "notes, or other securities," when even the Board concedes that commercial paper is "notes" within the plain language of the Act and this Court repeatedly has admonished that this statutory language is to be construed broadly and applied literally?

2. Did the majority below err in holding that the Federal Reserve Board is free on a "case-by-case" basis to "adapt" the underwriting prohibition of the Glass-Steagall Act according to its administrative view of the risks involved and regardless of the banks' marketing role, when Congress itself has repeatedly refused to grant any exemptive authority over the Act's flat prohibition to any administrative agency?

PARTIES TO THE PROCEEDING

In addition to the petitioners* and respondents listed in the caption, the following are also respondents in those consolidated actions: Paul A. Volcker as Chairman of the Board of Governors of the Federal Reserve System ("Board"), Frederick H. Schultz, Nancy H. Teeters, J. Charles Partee, Henry C. Wallich, Emmet J. Rice and Lyle E. Gramley as Members of the Board.

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* Pursuant to Rule 28.1 of this Court, petitioner Securities Industry Association states that it is a national trade association representing more than 500 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States.

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BRIEF OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

PRELIMINARY STATEMENT

This case involves a statutory "interpretation" of the Glass-Steagall Act that sanctions a result Congress itself sought to prohibit through the statute. In order to eliminate the potential for abuses and conflicts of interest inherent in the combination of commercial and investment banking, Congress separated

those activities as completely as possible. Through the Act Congress mandated, not case-by-case regulation of bank underwriting activities, but a flat statutory prohibition.

The Act expressly bars banks from underwriting "notes, or other securities". Refusing to apply this language literally, despite this Court's repeated admonitions to do so, the Board found commercial paper notes are not "notes" or "securities". The Board also applied a functional analysis that ignores the role of banks and permits it administratively to exempt any number of securities from the Act on a case-by-case basis by applying a host of factors found nowhere in the statute.

As will appear, the decision below, upholding the Board's ruling, should be reversed.

OPINIONS BELOW

The opinions of the Court of Appeals for the District of Columbia Circuit (220A)[1] are reported at 693 F.2d 136. The decisions of the Court of Appeals for the District of Columbia Circuit denying a joint petition for rehearing (258A) and suggestion for rehearing *en banc* (260A) are unreported.

The opinion of the District Court for the District of Columbia granting summary judgment in favor of petitioners (194A) is reported at 519 F. Supp. 602. The administrative ruling of the Board (122A) issued in response to petitions by the Securities Industry Association ("SIA") and A. G. Becker Incorporated ("A. G. Becker") is unreported, and the Board's subsequent "Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks" (183A) is reported at 46 Fed. Reg. 29333 (June 1, 1981).

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1 Citations herein to material printed in the Joint Appendix appear as "____A".

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on November 2, 1982. A timely petition for rehearing and suggestion for rehearing *en banc* was denied by orders entered on February 2, 1983. A joint petition for certiorari was filed on April 29, 1983; certiorari was granted on October 3, 1983. The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Two sections of the Glass-Steagall Act are involved here.[2] Section 16 of the Act provides, in relevant part:

> [A national bank] shall not underwrite any issue of securities or stock; . . . .

12 U.S.C. § 24 (Seventh) (Supp. IV 1980).[3] Section 21 of the Act provides, in relevant part:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a

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2 What is generally known as the Glass-Steagall Act was enacted as part of the Banking Act of 1933, 48 Stat. 162, and is codified in various sections of Title 12 of the United States Code. Relevant to this action are sections 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh) and 378.

3 The terms of section 16, which expressly apply to national banks, are also made applicable to state member banks of the Federal Reserve System, such as Bankers Trust Company, by 12 U.S.C. § 335.

> passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

12 U.S.C. § 378(a)(1) (1976).

STATEMENT OF THE CASE

A. The Administrative Proceedings

In 1978 Bankers Trust Company ("Bankers Trust"), a state-chartered commercial bank, initiated an aggressive campaign to convince existing and prospective corporate customers to distribute their commercial paper (*i.e.*, unsecured, short-term notes) through the bank, rather than through securities dealers. (*See* 33A; 39A-53A; 59A-69A.) Bankers Trust shortly thereafter began to market third-party commercial paper notes—the first time any bank had done so since the Glass-Steagall Act was adopted by Congress 50 years ago.

The SIA, representing over 90 percent of the securities firms in the country, and A. G. Becker, a major dealer in commercial paper, separately petitioned the Board to declare that the bank's activity violated the Glass-Steagall Act and to order the bank to cease and desist from its third-party commercial paper activity. (196A.)

The Board denied the petitions. (122A, *et seq.*) Although the Board recognized that the issues involved were primarily legal in nature (126A, 143A), conceded that the statute expressly precludes banks from underwriting "notes" (131A), and admitted that commercial paper comprises short-term notes (122A), the Board concluded that the statute should not be accorded a literal reading. (131A.) The Board instead adopted a "functional" analysis which, ignoring the bank's role in distributing the notes, concluded that their sale was the equivalent of a commercial loan to the issuer and therefore that bank participation of any type was appropriate. (135A-136A.)

The Board's ruling also conceded the "potential unsafe and unsound practices" that might proliferate if banks generally

were to begin dealing in commercial paper. (141A.) The Board therefore issued "guidelines" to govern the sale of commercial paper notes by all state bank members of the Federal Reserve System. (182A-189A.) The Board's action thereby not only permitted one bank to engage in these marketing activities, but in effect encouraged all member banks to do likewise.

After the Board's ruling, the SIA and A. G. Becker commenced lawsuits under the Administrative Procedure Act, 5 U.S.C. §§ 701, *et seq.*, before the District Court for the District of Columbia, challenging the ruling as contrary to law.

B. The District Court Decision

On cross-motions for summary judgment, the District Court (Joyce Hens Green, J.) held that commercial paper, which by the Board's own admission constitutes notes, fits squarely within the proscriptions against bank underwriting of corporate "notes" and "securities" set forth in sections 16 and 21 of the Glass-Steagall Act. The District Court refused to accept the narrow statutory construction proposed by the Board, noting that "[t]he statute draws broad lines, leaving no room for administrative amendment." (214A.)

The District Court also rejected the Board's "functional" argument that, because of its relatively short maturity, the nature of its purchasers, and other non-bank related factors, the commercial paper sold by Bankers Trust functions more as a commercial loan than as a security. That analysis was fundamentally incorrect, the District Court concluded, because "it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account, . . . or purchases for future sale to an outside party or arranges a transaction between purchaser and seller." (217A.)

Holding the Board's ruling to be contrary to law, the District Court concluded that the Board had improperly redrawn the congressionally mandated boundary between commercial and investment banking (218A; footnote omitted):

The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.

C. The Court of Appeals Decision

In a split decision the Court of Appeals reversed the District Court.

1. The Majority Opinion

The majority's principal reason for reversal was its view that, although the issue presented was purely legal in nature, the Board should be free to "adapt" the statute on a "case-by-case basis" according to the Board's view of "current business reality". (228A.) Despite the broad language of sections 16 and 21 of the Act, prohibiting banks from underwriting all corporate "notes" and "securities," and despite this Court's repeated direction that those terms are *not* to be construed narrowly, the majority concluded that a "narrower meaning" should be accorded the statutory terms. (235A.) In the majority's view, the terms include only "instruments for raising capital as part of the permanent financial structure of a corporation," while "implicitly permitting" banks to underwrite all other types of debt instruments. (236A.)

The majority also addressed the Board's "functional analysis". While recognizing that in certain loan transactions a bank *purchases* commercial paper, the majority held that the bank here "is simply on the other side of the transaction." (246A.) Thus, viewing the role of the bank as immaterial, the majority focused instead on characteristics such as the financial soundness of commercial paper issuers, the sophistication of its purchasers and the relatively low risk nature and short maturity of commercial paper, to conclude that such notes do not give rise to the hazards at which the Glass-Steagall Act was directed. (244A-249A.)

The majority held that the terms "notes" and "securities" in the Act did not encompass "prime quality commercial paper, of maturity less than nine months, sold in denominations of

over $100,000 to financially sophisticated customers rather than to the general public." (249A; footnote omitted.) Significantly, however, it conceded that other commercial paper "of smaller denominations, or issued to the general public," could well be a "note" or "security" under the Act. (250A.) The majority's holding, in short, was premised upon its conclusion that the Board is free to define what "securities" are covered by the Act based solely upon the Board's assessment of the hazards that banks might encounter in underwriting them.

2. The Dissent

Senior Circuit Judge Robb dissented from the majority's analysis, finding that "the majority's holding contravenes the fundamental policy of the Glass-Steagall Act." (250A.) Judge Robb rejected the functional analysis followed by the Board and adopted by the majority, noting, as had the District Court, that it ignores the bank's role, which is actually "[t]he critical distinction between commercial banking and investment banking." (251A.)

Judge Robb also rejected the majority's focus on factors such as low default rates and sophistication of investors, pointing out that by "[r]elying on these factors, a bank could transform 'transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.' " (252A.) Judge Robb observed that Congress flatly prohibited bank underwriting of corporate securities "without regard to the likely 'soundness' of the securities which a bank might sell." (255A.) As he stressed, the Act "has no provision permitting bank sales of securities which are 'prime quality' or 'very low-risk'." (253A.) Judge Robb also found that bank marketing of commercial paper gives rise to precisely the sort of potential abuses and hazards reviewed by this Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971).

Finally, Judge Robb disagreed completely with the majority's attempt to "force a narrow meaning onto the terms of the Act." (256A.) In his view, the terms used by Congress—"stocks," "bonds," "debentures," "notes" and "other securities"—are all-encompassing and were intended to be so.

SUMMARY OF ARGUMENT

Point IA: Enacted following the economic chaos of the late 1920's and the ensuing banking crisis of the early 1930's, the Glass-Steagall Act was intended to separate commercial from investment banking as completely as possible. Section 16 of the Glass-Steagall Act flatly prohibits banks from underwriting "any issue of securities or stock," and section 21 of the Act equally precludes entities engaged in underwriting "stocks, bonds, debentures, notes, or other securities" from also accepting deposits. Remedial statutes in general should be construed broadly, and this Court has admonished specifically that the terms of the Glass-Steagall Act are to be applied literally and are *not* to be read narrowly. The majority below nevertheless refused to apply the statutory terms literally and gave them a "narrower" reading, to exclude the commercial paper at issue. The majority thereby contravened the admonitions of this Court, the language of the statute and the intent of Congress. Commercial paper by definition is a "note" and therefore is also a "security" under the plain meaning of the terms. Bank marketing of commercial paper thus is prohibited.

Point IB: Congressional intent to include commercial paper within the terms "notes" and "securities" as used in the Glass-Steagall Act is confirmed by its use of those terms in other legislation passed during 1933-35, along with the Glass-Steagall Act and its initial amendments. As this Court has confirmed, language used in contemporaneous statutes carries great weight in ascertaining Congressional intent. Congress broadly defined "securities" as including any "note" in several statutes enacted concurrently with the Glass-Steagall Act, but then expressly excluded commercial paper from coverage. Congress made no such exception for commercial paper in the Glass-Steagall Act, which broadly covers "notes" and "securities," and the legislative history of that Act contains no indication that such an exclusion was intended. The majority's attempt to write into the Glass-Steagall Act an exception for commercial paper that Congress itself omitted is thus unfounded and contrary to congressional history.

Point IIA: The majority below viewed the Glass-Steagall Act as allowing the Board to "adapt" the Act's underwriting prohibition on a "case-by-case basis" to accommodate the Board's view of "current business reality." Actually, Congress on several occasions rejected such a *regulatory* approach to the statute and chose instead flatly to *prohibit* banks from dealing in securities. For example, in 1932 Congress considered authorizing banks to continue underwriting securities under federal regulation and inspection but ultimately dropped that approach. Again, in 1935, when Congress considered the initial amendments to the Glass-Steagall Act, it specifically rejected an amendment that would have granted banks the authority "under regulation" to "underwrite and sell . . . notes." The Board, affirmed by the majority below, nevertheless by regulation has permitted banks to underwrite commercial paper based upon a host of factors (such as maturities, denominations and breadth of distribution) nowhere found in the statute. In effect, the Board unilaterally has assumed the sort of administrative authority that Congress repeatedly has denied.

Point IIB: The Board also applied a "functional analysis," under which it sought to determine whether commercial paper evidences a transaction "functionally similar to a commercial banking operation." Focusing that analysis solely on factors such as the sophistication of commercial paper issuers and investors, the Board ignored almost entirely the role of *banks* in the transactions, thereby again circumventing congressional intent. The Glass-Steagall Act was intended to protect the interests of *banks* and their depositors. Accordingly, if any "functional analysis" is to be undertaken under the Act, its focus throughout should be on the role of the *bank*. Historically, when banks had purchased commercial paper for their own account, the transactions served essentially as bank loans, with the banks assessing the commercial paper solely from the perspective of a lender. Here, the bank serves only as a middleman, selling third-party commercial paper to other investors. The commercial paper serves the same function as do securities for investment bankers—a vehicle for earning promotional or underwriting fees depending upon marketing successes. In marketing the paper, the bank is subject to the same

sort of "promotional incentives" and "pecuniary stake" that the Glass-Steagall Act was meant to prevent for depository institutions. Potential abuses and conflicts of interest between a bank's obligation to render disinterested financial advice and its incentives to earn fees, are inherent in its position—precisely the circumstance the Glass-Steagall Act was intended to prevent.

Point III: The decision below improperly defers to the Board's analysis of a purely legal issue of statutory construction, as to which the courts are the final authorities. Left standing, the majority decision will simply encourage other bank regulators to assume similar, unauthorized authority to make fundamental policy decisions that may only properly be made by Congress.

ARGUMENT

I.

THE GLASS-STEAGALL ACT PROHIBITS BANKS FROM UNDERWRITING COMMERCIAL PAPER

The Glass-Steagall Act was "a prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 639 (1971) ("*ICI* I"). Through the Act, Congress meant to "separat[e] as completely as possible commercial from investment banking. . . ." *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 70 (1981) ("*ICI* II"). Sections 16 and 21 of the Act "flatly" and "entirely" prohibit banks from underwriting corporate securities. *Id.* at 58-59, n.24.

A. The Plain Language of the Act Prohibits Bank Underwriting of Commercial Paper

The question of statutory interpretation presented is whether short-term corporate notes, commonly referred to as commer-

cial paper,[4] are "notes" and/or "securities" within the meaning of sections 16 and 21 of the Act. Statutory construction, of course, starts with "the language of the statute itself."[5] The words used by Congress should be accorded "their ordinary, contemporary, common meaning,"[6] and, where unambiguous, that meaning "*must ordinarily be regarded as conclusive*."[7]

The terms of section 16 preclude banks from underwriting "any issue of securities or stock." Section 21, in turn, precludes entities engaged in underwriting "stocks, bonds, debentures, notes, or other securities" from simultaneously accepting deposits. This language itself demonstrates the expansive scope intended by Congress. As Judge Robb put it (256A-257A):

> The terms "stocks", "bonds", "debentures", and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments a corporation might seek to market.

Commercial paper unquestionably constitutes "notes" as that word is commonly understood.[8] The Board and the

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4 As defined by the majority below, " '[c]ommercial paper' refers to prime quality, negotiable promissory notes bearing very short maturities—generally 30 to 90 days." (223A; footnote omitted.)

5 *E.g.*, *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979).

6 *Perrin* v. *United States*, 444 U.S. 37, 42 (1979).

7 *American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 68 (1982) (emphasis added; citations omitted). *Accord*, *Aaron* v. *SEC*, 446 U.S. 680 (1980); *Lewis* v. *United States*, 445 U.S. 55 (1980).

8 The term "note" is conventionally defined as "a written promise of the maker to pay a certain sum of money to the person named as payee, on demand or at a fixed or determinable future date." Munn, *Encyclopedia of Banking and Finance*, 698 (7th ed. 1973) ("Munn").

majority below both agreed that commercial paper comprises unsecured, short-term promissory *notes*. (122A, 223A.) It is equally clear that, as a note, commercial paper is a "security," under any common-sense definition of the term.[9] Congress' juxtaposition of the terms "notes" and "other securities" in section 21 of the Act confirms that it viewed notes as merely one type of "securities" for purposes of that section and thus, logically, for purposes of section 16 as well. *See ICI* I, 401 U.S. at 635. In sum, the language of these sections, on their face, plainly precludes banks from underwriting commercial paper. This should be "regarded as conclusive".

Indeed, if there were any ambiguity in these remedial provisions, which there is not, the presumption should be in favor of covering any instrument as to which there is a question. Remedial statutes are to be construed broadly, with their prohibitory terms enforced strictly. *E.g.*, *Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967). This Court has admonished, in *every* case which has considered the meaning of terms of the Glass-Steagall Act, that its prohibitions are not to be accorded a narrow or a technical meaning.[10]

The broad terms of sections 16 and 21, therefore, are to be applied "as they were written". *ICI* I, 401 U.S. at 639. This Court has "relied squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act . . . [and] recognized that the statutory language plainly applied." *ICI* II, 450 U.S. at 65. Specifically as to the term "securities," this Court has instructed:

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9 *E.g.*, Black's Law Dictionary, 1215 (5th ed. 1979) (defining "securities" as "[e]vidences of debts or of property" and specifically including "notes" as a form of securities); Munn, *supra*, at 828 (defining "securities" to include "notes . . . of every kind").

10 *See ICI* II, 450 U.S. at 65; *ICI* I, 401 U.S. at 635; *Board of Governors* v. *Agnew*, 329 U.S. 441, 446-47 (1947); *Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935) (construing terms of the McFadden Act reenacted as part of the Glass-Steagall Act).

> [T]here is nothing in the phrasing of either § 16 or § 21 that suggests a narrow reading of the word securities. To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

ICI I, 401 U.S. at 635.

The majority below nevertheless decided that the terms "notes" and "securities" should *not* be construed literally, but rather should be accorded a "narrower meaning." (235A.) The "narrower meaning," however, was not that all commercial paper is excluded from the Act. Rather, deferring to the Board, the majority held that the basic terms "notes" and "securities" exclude only "prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000 to financially sophisticated customers rather than to the general public." (249A-250A.) At the same time, the majority conceded that "another type of commercial paper—*e.g.*, of smaller denominations, or issued to the general public—might be a 'security' under the Glass-Steagall Act." (250A.)

That the Board and the majority found it necessary to resort to this sort of "now-you-see-it-now-you-don't" definition of "notes" and "securities" alone confirms the wisdom of this Court's repeated admonition that the terms are to be construed broadly and applied literally.

Nor does the majority's reasoning support its result. The majority found that the language of the Act can be read as barring banks only "from trading in specified instruments for raising capital as part of the permanent financial structure of a corporation" and "implicitly" permitting banks to underwrite all other debt instruments.[11] (235A-236A.) As noted, however, the majority specifically limited its holding to prime quality, large denomination notes sold only to sophisticated pur-

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11 Actually, if Congress had intended such a limited scope, it would have said so explicitly, as it has done in the banking laws in other contexts. *E.g.*, 12 U.S.C. § 321 ("capital notes").

chasers—factors that have nothing whatever to do with whether the notes are capital raising instruments. Conversely, the majority thought that smaller denomination or more broadly distributed commercial paper could well be "securities" under the Act, again without any reference at all to whether they are used for raising capital.

The majority also inappropriately parsed the Act, interpreting sections 16 and 21 separately from one another, even though this Court has recognized the congruity of these sections and has construed them together. *See ICI* I, 401 U.S. at 635. The two sections are reflections of one another, both intended to separate commercial and investment banking. For the majority to conclude (233A) that underwriting "notes," expressly prohibited by section 21, is not prohibited by section 16 because the latter refers to securities or stock, but "in no way refers explicitly to notes" (233A), is simply to miscast the statutory structure.

Considering section 16 in isolation, the majority went so far as to indicate that Congress supposedly did not intend to prohibit bank "underwriting" of all notes because it permitted banks to "discount and negotiate" promissory notes. (233A.) Not only were the terms, which have very different meanings,[12] added to the statute 70 years apart,[13] but if the majority were correct, banks have for more than a century had the authority to underwrite commercial paper. Yet, there is no evidence that banks generally did so previously and they certainly have not

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12 *Compare* Munn, *supra*, at 650-651 and U.C.C. § 3-202 *with* Munn, *supra* at 912 and Securities Act of 1933, § 2(11)g, 15 U.S.C. § 77b (11).

13 The authority for national banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes," was included as part of the original National Bank Act of 1864, c. 106 § 8, 13 Stat. 101. The express prohibition against "underwriting" was not added until 1933 in the Glass-Steagall Act.

done so since the Glass-Steagall Act was passed.[14] As recognized in *BankAmerica Corporation* v. *United States*, ___ U.S. ___, 103 S.Ct. 2266, 2272-73 (1983), such consistent conduct over many years reflects "what was universally perceived as plain statutory language" and further indicates that the Act should be "interpreted according to its plain meaning."

The majority equally misconstrued the language of section 21, which prohibits banks from underwriting "stocks, bonds, debentures, notes, or other securities." To support its conclusion that section 21 had a restricted coverage, the majority read this language in reverse, concluding that section 21 covers only those "securities" that are in the nature of "notes" that, in turn, are in the nature of "debentures" and "bonds". (234A-235A.) If Congress had intended the statute to be read backwards, however, it would have written it that way. It did not.

As enacted, the language of section 21 shows that Congress intended the broadest possible coverage, with the term "other securities" encompassing any instruments not specifically listed. (256A-257A, Robb, J.) When Congress uses a series of broad exemplars, as it has here, such language "offers no indication whatever that Congress intended [a] limiting construction." *Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578,

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14 The majority below cited the fact that banks had "dominated" the commercial paper market since the 19th century (238A, n.56), ignoring completely that until now the banks' role was as *purchaser* of commercial paper not as distributor. *E.g.*, Steiner, *The Commercial Paper Business*, 7 Fed. Res. Bull. 920, 923 (1921); Federal Reserve Bank of Chicago, *A Larger Role for Commercial Paper* 4, 9 (1968). Before the Glass-Steagall Act was passed, banks did *not* regularly distribute commercial paper, although some smaller banks are believed to have undertaken limited distribution as an accommodation to an existing customer. There is no evidence that banks acted as commercial paper underwriters at all after the Act was passed. Foulke, *The Commercial Paper Market* 107-108 (1931); Greef, *The Commercial Paper House* 379, 403-04 (1938); Selden, *Trends and Cycles in the Commercial Paper Market* 11-13 (1963).

588-89 (1980). This is a classic example of a court's creating ambiguity where there is none and, having done so, misconstruing the plain language used by Congress.[15]

Moreover, in concluding that commercial paper notes are not notes in the nature of "bonds" and "debentures"—which terms the majority construed as exclusively "long-term investment securiti[es]" (234A)—the majority overlooked that bonds and debentures are also issued in short maturities, some shorter than the maturities of the commercial paper at issue.[16] Conversely, while technically of short-term duration, commercial paper notes are often "rolled over" regularly to provide an on-going source of long-term funds for the issuer.[17]

The majority's further conclusion that Congress supposedly intended to remove banks only from "participation in 'speculative' securities markets" (236A) makes no sense against the

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15 *See id.* Maxims of statutory construction are not to be applied so as to "obscure and defeat the intent and purpose of Congress." *United States* v. *Alpers*, 338 U.S. 680 (1950). *See United States* v. *Turkette*, 452 U.S. 576 (1981); *United States* v. *Powell*, 423 U.S. 87, 91 (1975).

16 *E.g.*, *Wall Street Journal*, Oct. 27, 1983 at 40 (Port Authority of New York and New Jersey, notice of public offering including seven-month bonds); *id.*, Oct. 17, 1983 at 45 (Triborough Bridge and Tunnel Authority, notice of public offering including three-month revenue bonds); *id.*, Oct. 5, 1983 at 42 (South Dakota Student Loan Assistance Corporation, notice of public offering including nine-month revenue bonds).

17 The virtual impossibility of tracing a particular source of funds to working capital or fixed capital uses makes it impossible to establish whether the proceeds from commercial paper actually are being used for short-term, current transactions. Handal, *The Commercial Paper Market and the Securities Act*, 39 U. Chi. L. Rev. 362, 389 (1972); Federal Reserve Bank of Chicago, *A Larger Role for Commercial Paper*, 2, 12 (1968). Accordingly, commercial paper can be and is used to finance an issuer's long-term needs. *E.g.*, Securities and Exchange Commission, No-Action Letters, Liberty National Corp., May 6, 1983 (commercial paper proceeds used, in part, to finance mortgage loans and mobile home loans); First Jersey National Corp., June 4, 1981 (commercial paper proceeds used to acquire bank subsidiary).

overall statutory structure. Congress specified in great detail, both when the Act was passed and in subsequent amendments, a series of at least 15 separate U.S. government or general obligation municipal securities (*i.e.*, very low risk securities) in which *it* has decided that trading by banks is to be permitted. 12 U.S.C. § 24 (Seventh) (Supp. IV 1980). These statutory exceptions would have been unnecessary if Congress had already excluded "low risk" securities generally from the reach of the Act.[18] Instead, Congress specifically defined what securities are not too "risky" for purposes of the Act.[19] As Judge Robb noted, the Act simply "has no provision permitting bank sales of securities which are 'prime quality' or 'very low risk'." (253A.)

In plain language, the Glass-Steagall Act flatly and unambiguously prohibits banks from underwriting all corporate "notes" and "securities," including those notes referred to as commercial paper. For this reason alone the decision below should be reversed.

B. Contemporaneous Congressional Action Confirms that Commercial Paper Was Intended to be Covered by the Act

Confirmation, if confirmation were needed, that Congress intended commercial paper to be within the prohibition against bank underwriting of "notes" and "securities" can be found in Congress' contemporaneous use of the term "security" in several related statutes:

Securities Act of 1933, 15 U.S.C. §§ 77a, et seq.: Congress enacted this statute just three weeks before it passed the

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18 Also, if Congress intended only "speculative" securities to be covered by the Act, its express exception in section 16, permitting banks to purchase "investment securities" (*i.e.*, securities that are "not predominantly speculative," 12 C.F.R. § 1.3(b)), would be superfluous.

19 *Baker, Watts & Co. v. Saxon*, 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom., Port of New York Authority v. Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968) (trading in securities, be they "gilt-edged" or otherwise, is proscribed).

Glass-Steagall Act. The two statutes were being considered by the same congressional committee at the same time. During the committee hearings on the Securities Act, Senator Glass attempted to persuade Congress to exclude "9 months commercial paper" from the definition of "security" in order to avoid interfering with ordinary bank lending transactions.[20] Congress rejected this exclusion, refusing to insert an exception for commercial paper and broadly defining "security" to include any "note." *See* 15 U.S.C. § 77b(1). To accommodate Senator Glass' concern, however, commercial paper was specifically exempted from the Act's registration and prospectus requirements.[21] Congress' consideration and rejection of the Glass amendment leaves no doubt that it understood commercial paper to be a "security" and a "note" as those terms are commonly understood.

Securities Exchange Act of 1934, 15 U.S.C. §§ 78a, et seq.: During 1934 and 1935, when Congress was considering amendments to the Glass-Steagall Act proposed by the Comptroller of the Currency and others,[22] it was also considering the bill which became the Securities and Exchange Act. *See Hearings on H.R. 5357 Before the House Committee on Banking and Currency*, 74th Cong., 1st Sess. 179-80 (1935)

20 *See Hearings on S. 875 Before the Senate Committee on Banking and Currency*, 73rd Cong., 1st Sess. 98 (1933).

21 Section 3(a)(3) of the Securities Act exempts from the Act's registration and prospectus requirements, but *not* from its definition or antifraud provisions:

> *[a]ny note*, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or *the proceeds of which* have been or *are to be used for current transactions, and which has a maturity* at the time of issuance of *not exceeding nine months*. . . (Emphasis added.)

15 U.S.C. § 77c(a)(3).

22 *See, e.g.*, Annual Report of the Comptroller of the Currency, 8-12 (Jan. 3, 1934); *Hearings on S.1715 and H.R. 7617 Before the Senate Committee on Banking and Currency*, 74th Cong., 1st Sess. 113 (1935); *Hearings on H.R. 5357 Before the House Committee on Banking and Currency*, 74th Cong. 1st Sess. 661 (1935).

(testimony of Federal Reserve Board Chairman, Marriner S. Eccles, recognizing the contemporaneous enactment and similarity of purpose of these statutes). In enacting the Securities Exchange Act in 1934, however, Congress expressly excluded commercial paper from the Act's definition of "security"—which otherwise included any "note" (15 U.S.C. § 78c(a)(10))—again confirming its understanding that commercial paper would be considered a "security" under the ordinary meaning of that term, unless an express exception were provided.

Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 et seq.: Congress considered this Act at the same time it was debating the proposed amendments to the Glass-Steagall Act that were ultimately encompassed in the National Banking Act of 1935, c.614, §§ 303, 308, 49 Stat. 707. These statutes were enacted on successive business days—Friday, August 23 and Monday, August 26, 1935, respectively. In the National Banking Act of 1935 Congress, *inter alia*, changed the term "investment securities" in section 16 to "securities and stock." 12 U.S.C. § 24 (Seventh). In the Public Utility Holding Company Act, Congress prohibited registered holding companies from acquiring any "securities" but permitted purchase of "*such commercial paper and other securities*" as the Securities and Exchange Commission might allow by rules and regulations. 15 U.S.C. §§ 79b(a)(16), 79i(c)(3). Again, as shown by its use of the phrase "and *other* securities," Congress unquestioningly understood commercial paper to be a type of "security" within the plain meaning of that term. *See also*, H.R. Rep. No. 1318, 74th Cong., 1st Sess. 15 (1935) ("a third class of securities permitted under this subsection is commercial paper").

Express Congressional language used in contemporaneous statutes, as this Court has instructed, reveals " 'the meaning of the words as used in their contemporary setting,' " and is " 'entitled to great weight in resolving any ambiguities and doubts.' " *Erlenbaugh* v. *United States*, 409 U.S. 239, 244 (1972), *quoting United States* v. *Stewart*, 311 U.S. 60, 64-65

(1940). Against history recited above, it is patently illogical to conclude, as did the Board (132A) and the majority below (236A-238A), that Congress did not understand commercial paper to be a "security" when it enacted the Glass-Steagall Act.

The absence of specific discussion concerning commercial paper underwriting during congressional debates on the Glass-Steagall Act, cited by the majority (236A), is hardly surprising. No discussion should be expected, in that with rare exceptions banks then were not dealing in commercial paper. (*See supra*, n.14.) Their activities had been limited to purchasing commercial paper for their own accounts (*i.e.*, lending), and that was the purport of the little congressional discussion which occurred.[23] In any event, the *lack* of congressional discussion on a topic cannot be turned into the "rare and exceptional circumstances" needed "to make plain the intent of Congress that the letter of the statute is not to prevail."[24]

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23 Senator Walcott, floor manager of the Glass bill, for example, was concerned that corporations had stopped meeting their financial needs "by borrowing at commercial banks upon their commercial paper—that is, upon their notes." 75 Cong. Rec. 9904 (1932) (emphasis supplied). Not only were "commercial paper" and "notes" thus viewed as synonymous, but the correct role for banks was regarded to be that of lenders, i.e., purchasers, of commercial paper for their own accounts.

24 *Crooks* v. *Harrelson*, 282 U.S. 55, 60 (1930), *quoted in Rubin* v. *United States*, 449 U.S. 424, 430 (1981) and *TVA* v. *Hill*, 437 U.S. 153, 187 n.33 (1978).

The majority also cited Representative McFadden's earlier statement that commercial paper was not considered an investment security under the McFadden Act of 1927. The majority reasoned that banks therefore were "left free to trade in commercial paper without restriction" after that statute was enacted. (237A-238A.) But, the majority had it backwards. Banks never had the authority "to trade in commercial paper," and the significance of the McFadden statement is simply that no such authority was provided even under the McFadden Act, which marked the first time Congress expressly recognized the authority of banks to deal in investment securities. *See Awotin* v. *Atlas Exchange National Bank*, 295 U.S. 209, 212 (1935). Because of their

It is equally unsound to reason that Congress intended in the Glass-Steagall Act *implicitly* to make the distinction between commercial paper notes and notes generally, that it made *explicitly* in the other statutes discussed above. As this Court instructed in another context:

> Had Congress intended so fundamental a distinction, it would have expressed that intent clearly in the statutory language or the legislative history. It did not do so, however, and it is not this court's function "to sit as a super-legislature," *Griswold v. Connecticut*, 381 U.S. 479, 482 (1965), and create statutory distinctions when none were intended.[25]

The Board, in essence, sought to take the express exception for commercial paper included in other contemporaneous statutes and administratively engraft it onto the Glass-Steagall Act. (136A, n.26.) But, as this Court held in construing a different statute in *Erlenbaugh* v. *United States*, *supra*, to do so would "carve a substantial slice from the intended coverage of the statute. This we will not do without an affirmative indication—which is lacking here—that Congress so intended." *Id.*, 409 U.S. at 247.

In sum, congressional action contemporaneous with the consideration, enactment and initial amendment of the Glass-Steagall Act confirms what is apparent from its plain language: commercial paper is both a "note" and a "security" within its coverage, and bank underwriting of it is prohibited. For this reason also, the decision below should be reversed.

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express authority to discount and negotiate promissory notes, however, banks could continue to purchase commercial paper for their accounts as they had been doing for years. And, contrary to the majority's further view (238A, n.59), banks can thereby continue to do so now.

25 *American Tobacco Co.* v. *Patterson*, *supra*, 456 U.S. at 71, n.6. *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 572 (1979) (when Congress wished to provide an exception to a statute "it knew how to do so and did so expressly").

II.

THE REGULATORY APPROACH ADOPTED FRUSTRATES THE CONGRESSIONAL POLICY UNDERLYING THE GLASS-STEAGALL ACT

The decision of the majority below has an even broader significance than its distortion of the plain language of the Act. It effectively transforms the Act's absolute prohibitions into mere regulatory guidelines subject to *ad hoc* administrative adjustment—directly contrary to congressional intent.

A. The Majority Below Sanction the Exercise of Discretionary Authority Expressly Withheld by Congress

The majority viewed the Glass-Steagall Act as permitting the Board to "adapt" the flat prohibition against bank underwriting on a "case-by-case basis" to accommodate the Board's view of "current business reality." (228A.) But the Glass-Steagall Act was an unusual statute. Unlike other contemporaneous legislation conferring discretionary, regulatory authority,[26] the Act was a prohibitory statute, the terms of which are to be construed broadly and applied literally. *ICI* I, 401 U.S. at 639. Nothing in the statute itself or its legislative history supports the majority's regulatory approach.

Congress considered proposals merely to regulate, rather than prohibit, securities underwriting by banks when it initially formulated the Act, when it enacted the initial amendments to the Act, and repeatedly thereafter. Each time, Congress rejected the regulatory approach.

Early proposals considered by the Senate Banking Committee in 1932, for example, would have authorized banks to continue dealing in and underwriting securities of private issuers under federal regulation and inspection. The proposals

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26 *See infra*, p. 24 & n.31.

were dropped.[27] Congress was obviously convinced that a more "drastic step"[28] was necessary. As Senator Bulkley, a senior member of the Senate Banking Committee, put it at the time the Glass-Steagall Act was being considered:

> If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep banks out of the investment security business.

75 Cong. Rec. 9912 (1932); cited approvingly in *ICI* I, 401 U.S. at 635. To achieve this, Congress enacted the flat prohibitions found in sections 16 and 21 of the Act.

In marked contrast with section 32 of the Act, 12 U.S.C. § 78, which permits the Board to exempt certain arrangements from the Act's management interlock provisions,[29] neither section 16 nor section 21 vests *any* exemptive authority whatsoever in the Board. The *only* administrative authority contained in the latter sections authorizes the Comptroller of the Currency "by regulation" to permit banks to purchase invest-

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27 *See* Willis and Chapman, *The Banking Situation* (1934). The Senate Banking Committee drafted legislation that would have allowed continued underwriting activities by banks subject to federal inspection and regulation, under penalty of expulsion from the Federal Reserve System. This proposal was ultimately dropped in favor of the complete separation of commercial and investment banking in response to "great numbers of letters from citizens of all classes . . . who demanded absolute elimination of [bank securities affiliates]—root and branch—from the national banking and Federal Reserve systems." *Id.* 68-69.

28 *ICI* I, 401 U.S. at 629.

29 Section 32 of the Act prevents officer, director or employee interlocks between member banks of the Federal Reserve System and any entity engaged in securities distribution or sale. It provides, however, that "in a limited class of cases" the Board may allow interlocks "when in the judgment of the Board it would not unduly influence the investment policies of such member bank or the advice it gives its customers." 12 U.S.C. § 78.

ment securities for their own account, not to deal in or underwrite them.

In 1935 Congress actually considered providing similar regulatory authority to permit bank underwriting of securities. The version of the Banking Act of 1935 passed by the Senate included a provision amending section 16 of the Glass-Steagall Act to permit "national banks, under regulation by the Comptroller of the Currency, to *underwrite and sell* bonds, debentures, and *notes*."[30] This of course is precisely what the Board has authorized here. But the House refused to provide this regulatory authority, and the Conference Committee struck the Senate provision. Conf. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935). The amendments of 1935, as enacted by Congress, continued the flat prohibitions in sections 16 and 21 against bank underwriting of securities.

This Congressional action is all the more important in light of the differing approach it followed during 1933-35 in enacting the federal securities laws. In those statutes Congress chose to *regulate*, rather than prohibit, a number of activities, leaving the limits of statutory coverage to subsequent discretionary administrative action.[31] By contrast, in the Glass-Steagall Act Congress spoke as broadly as possible to *prohibit*, in advance, certain activities.

The absolute approach chosen by Congress in the Glass-Steagall Act is also underscored by contrast with more recent

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30 S. Rep. 74-1007, 74th Cong., 1st Sess. 16 (1935) (emphasis supplied). At the urging of the Comptroller of the Currency and others, Congress, during 1934-1935, considered various amendments proposed to the Act as it had been passed 100 days after President Roosevelt originally declared the five-day national banking holiday in 1933. *See supra*, p. 18, n.22.

31 *E.g.*, Securities Act of 1933, § 2, 15 U.S.C. § 77b; Securities Exchange Act of 1934, §§ 3, 15(a)(2), 23(a), 15 U.S.C. §§ 78c, 78o(a)(2), 78w(a). *See also*, Public Utility Holding Company Act of 1935, §§ 9, 20, 15 U.S.C. §§ 79i(c)(3), 79t.

banking legislation such as the Bank Holding Company Act, 12 U.S.C. § 1841, *et seq.* There, Congress did vest discretionary power in the Board to authorize bank holding companies to engage in those activities the Board finds to be "so closely related to banking as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8). But, as congressional debate over amendments to the Bank Holding Company Act during 1970 again confirmed, the Glass-Steagall prohibitions were not to be diluted. Senator Sparkman, floor manager of the 1970 amendments, explained in responding to concern about their effect upon the Glass-Steagall Act:

> As it now stands, the Glass-Steagall Act broadly prohibits both banks and their affiliates from engaging in what we commonly understand to be the securities business. . . . [W]e did not intend to amend or modify, directly or indirectly, any limitations on the activities of banks, bank holding companies or any of their affiliates, now contained in the Glass-Steagall Act. If Congress is to change that longstanding, fundamental statement of public policy, we will have to do so in other legislation.

116 Cong. Rec. 42430 (1970), quoted in *ICI* II, 450 U.S. at 75, n.55. No such "other legislation" has been enacted, and the Glass-Steagall prohibitions remain to be enforced strictly pursuant to Congress' "longstanding, fundamental statement of public policy."

Defying these repeated expressions of congressional intent, however, the majority has now construed the Act as permitting banks to underwrite notes, depending upon the Board's administrative view of a number of specific factors having no basis in the statutory language:

— the denominations of the instrument being sold;

— the breadth of distribution of the instruments;

— the degree of sophistication of the purchasers of the instruments;

— the financial strength of the entity issuing the instruments;

— the use to which the proceeds will be put by the issuing entity; and

— the amount of instruments previously underwritten for that issuer by the distributing banks.[32]

The Board, affirmed by the majority below, has simply—and incorrectly—assumed the sort of regulatory authority denied by Congress throughout half a century. The uncertainty of *ad hoc* administrative enforcement has replaced the certainty of Congress' prospective prohibition. The Act's flat statutory bar against underwriting of "notes or other securities" has become a regulatory filigree through which just such underwriting may pass.[33]

It is especially significant that this action comes at a time when Congress itself has been considering major legislative proposals to alter existing federal restrictions on financial institutions. In each of several recent sessions Congress has

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32 *See* Federal Reserve System, *Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks*, 46 Fed. Reg. 29333 (June 1, 1981) (the "guidelines"). (183A.)

33 The impact of the Board's ruling has not been limited to the securities and banking industries: it has already affected the carefully balanced regulatory system governing the nation's financial system. For example, because of what it described as the "abrupt change" effected by the Board's action allowing banks "for the first time" to underwrite securities, the Federal Energy Regulatory Commission was required immediately to issue a temporary blanket exemption from certain provisions of the Federal Power Act, 16 U.S.C. § 825d(b). *See* Order in Docket No. EL 81-5-000, March 27, 1981, 46 Fed. Reg. 19980 (April 2, 1981); 171A. The Securities and Exchange Commission was required to respond similarly to the Board's ruling, pursuant to its responsibilities under the Public Utility Holding Company Act. *See* SEC, Public Utility Holding Company Act Release No. 35-21967 (March 18, 1981), 46 Fed. Reg. 18535 (March 25, 1981).

enacted major reforms to the federal banking laws.[34] Not only has Congress expressly reaffirmed its opposition to administrative readjustment of the Glass-Steagall prohibitions,[35] but, in each instance, Congress has failed to modify the Glass-Steagall underwriting restrictions in the slightest.

In sum, fifty years of congressional history confirms that the prohibitions of the Glass-Steagall Act are to be applied broadly, as they were written. Any restriction of the Act's scope "must be implemented by Congress and not by a crabbed [administrative] interpretation of the words of the statute." *BankAmerica Corporation v. United States*, *supra*, 103 S.Ct. at 2273.

B. The "Functional Analysis" Adopted by the Majority Below Contravenes the Fundamental Objective of Congress

Even if a regulatory approach in general had been appropriate under the Act, the specific "functional analysis" employed by the Board and embraced by the majority below was not. Applied consistently with congressional intent, a "functional analysis" yields a result opposite to that reached below.

The stated objective of the functional analysis proposed by the Board was to determine whether commercial paper evidences a transaction "functionally similar to a traditional

34 *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 132 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

35 In the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980), Congress extended to the Comptroller of the Currency authority for the first time to issue such rules as are needed to "carry out the responsibilities of the office," but specifically reaffirmed in the statute that the Comptroller had *no* general authority to issue regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act'." 12 U.S.C. § 93a.

commercial banking operation." (242A.) If so, under the Board's reasoning, the instruments involved are outside the Act's coverage. Again adhering to the Board's logic, the majority below examined the characteristics of commercial paper, of its issuers and of its purchasers, but ignored the role of the *bank*. In so doing, both the Board and the majority missed the basic point of the statute.

The Glass-Steagall Act was intended to separate investment from commercial banking as completely as possible. *ICI* II, 450 U.S. at 70. As Judge Robb recognized in dissent, because "[t]he critical distinction between commercial banking and investment banking is the bank's role in the transaction," any interpretation of the Act "must focus on the bank's role in the transaction with a view to maintaining the Act's separation of functions." (251A-252A.) *See also*, Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L. J. 102 (1981).

A functional analysis viewed from the perspective of the bank leaves little question that the bank's handling of the commercial paper in question falls squarely within the Act. The majority below brushed off the difference between the traditional role of a bank in purchasing commercial paper, and this bank's proposed role of marketing the paper, as the bank's simply being "on the other side of the transaction." (246A.) As Judge Robb put it, however, "this distinction . . . is determinative under the Act." (251A.)

There is a vast difference between a bank *purchasing* commercial paper and a bank *distributing* commercial paper. Historically, when banks purchased commercial paper,[36] the transactions were essentially the same as if the corporate issuer had come into the bank and obtained a bank loan in the amount of the discounted value of the commercial paper. Either way, the bank was lending money to the corporation and deriving its revenue from the interest (or discount) accruing to it. As a lender, the sole concern of the bank was to assess the loan as a risk.

36 *See supra*, n.14.

In stark contrast, the bank here is not in any sense lending money to issuers of commercial paper. The bank's function is solely that of a marketer, which will earn its fees based upon its success in distributing the commercial paper of the issuers.[37] The commercial paper thus serves the same function for the bank that securities serve for investment bankers. The concern of a bank so involved is no longer simply to assess the paper as a lending risk, but rather to assess the paper as a vehicle for earning sales commissions or fees.

Reference to the factors relied upon by the majority, such as the sophistication of investors, the stability of issuers and the quality of investments, "provides no help in determining whether the bank's role in the transaction violates the Act." (Robb, J. 252A.) Reliance on such factors would permit banks to "transform 'transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.' " (*Id.*) Sophisticated investors and financially sound issuers frequently deal in high quality stocks and low-risk securities, but there is no doubt that such instruments are within the prohibitions of the Act.

The factors considered by the majority may be important in determining the application to particular instruments of other statutes, such as federal securities laws, because those statutes are intended to protect the interests of *investors*.[38] Yet, such factors have no bearing upon whether *banks* should be dealing in the instruments, which is the concern of the Glass-Steagall Act.[39] Summarizing the purpose behind sections 16 and 21 in *ICI* I this Court stated:

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37 *See* Judge Robb's dissent, contrasting a bank's role as "lender," when it purchases commercial paper, and a bank's role as "seller," when it markets the paper. (251A.)

38 *See, e.g., Tcherepnin* v. *Knight*, 389 U.S. 332, 336 (1967); *SEC* v. *Howey Co.*, 328 U.S. 293, 298-299 (1946).

39 As the majority below said, in seeking to dismiss the relevance to this case of definitions contained in the securities laws: "A different focus of analysis is called for under the Glass-Steagall Act, which aims

> Congress acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment bankers pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system.

ICI I, 401 U.S. at 634.

In *ICI* I this Court rejected administrative contentions, analogous to those of the Board here, that the activity at issue was permissible because of its relation to traditional bank activities.[40] Because the plan was "of a different character" from the historic bank role, and "in direct competition with" the mutual fund industry, it was held to be contrary to the prohibitions of the Glass-Steagall Act. *ICI* I, 401 U.S. at 625, 628. Here, too, the bank's activity will inevitably "give rise to a promotional or salesman's stake in a particular investment" and "will involve an enterprise in direct competition with aggressively promoted" commercial paper sold by investment bankers. *ICI* I, 401 U.S. at 638.

The promotional materials in the record reflect just such competition. They describe the bank's fee as "competitive with that of commercial paper dealers" (61A); refer to a sales distribution network that can "expand your commercial paper sales in a way that our competitors (either bank or dealer) cannot" (63A); and state that "unlike the investment bankers" the bank is "necessarily a short-term money market expert" (69A). In fact, potential customers are told that, even if the bank fails to sell all of an issuer's commercial paper, the bank

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at protecting the integrity of *banks* and the financial resources of *depositors* rather than *investors*." (241A; emphasis in original.)

40 The Comptroller contended that the bank's plan for collective investment of managing agency accounts was simply a derivative of the bank's powers to commingle trust funds and to act as a managing agent, both of which concededly were proper under the banking laws.

in effect will buy the balance for its own account, at its own risk, with a view toward possible resale.[41]

It is no accident that the bank makes these representations. They concern the type of services offered generally by commercial paper dealers. If the bank is to be "completely competitive" as it says (65A), so, too, must it offer the services. This Court's warning in *ICI* I applies equally here:

> When a bank puts itself in competition with mutual funds, the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking.

ICI I, 401 U.S. at 637.

Significantly, the Board acknowledged in its ruling that: "[T]he sale of third party commercial paper by a commercial bank could involve, at least in some circumstances, practices that are not consistent with principles of safe banking." (141A.) The Board then issued guidelines relating to the sale of commercial paper notes by banks (183A), but such action is not, and cannot be, a sufficient response. The Glass-Steagall Act was meant to eliminate, not merely to "minimize," the potential for abuse that is *inherent* in the combination of investment and commercial banking. As this Court stated repeatedly in *ICI* I, Congress enacted the Glass-Steagall Act not just to remedy existing abuses but to avoid "*potential*" hazards that "*might*" arise.[42] 401 U.S. at 637-38 (emphasis supplied); *see also*, *ICI* II, 450 U.S. at 66-67, n.38.

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41 The promotional materials in the record show that where the bank is unable to place all of an issuer's commercial paper, it may loan the issuer short term funds, "using the unsold paper as collateral". (37A.)

42 Indeed, any number of conflicts of interest are inherent in a bank's marketing of commercial paper. For example, if a bank sells commercial paper issued by one of its customers who subsequently has a need for money to "retire" the paper at maturity, the bank may feel compelled to lend the customer the money to do so. Additional conflicts and pressures are inherent in any transaction in which a bank

Nor do the factors that the Board seeks to regulate eliminate the hazards that bank underwriting of commercial paper presents. Penn Central's default on $82.5 million of commercial paper that, only three weeks earlier, had been marketed as "prime" quality and sold in large denominations to sophisticated purchasers,[43] dramatically confirms that no number of administrative "guidelines" can effectuate the Congressional purpose. As Judge Robb discussed at some length (253A-255A), the Board's present guidelines would have permitted banks to underwrite the Penn Central commercial paper, and yet such activities would have presented exactly the sort of hazards this Court cautioned against in *ICI* I, 401 U.S. at 630-33. The intent of Congress can only be carried out by prohibiting the activity entirely, which is precisely what the Glass-Steagall Act was designed to do.

In sum, the majority's "functional analysis" reflects the regulatory approach that Congress rejected and permits the potential risks that Congress prohibited. In so doing,

> [t]he majority's holding contravenes the fundamental policy of the Glass-Steagall Act . . . [which is] to insulate commercial banking from the hazards inherent in investment banking by mandating a complete separation of those two functions.

(250A; Robb, J. dissenting.) For this reason, too, the decision below should be reversed.

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agrees to market commercial paper issued by a corporation to pay down its outstanding loan from the bank. Again, if a bank sells commercial paper to a customer that subsequently has a need for cash before the commercial paper is due, the bank may feel obliged either to repurchase the paper or to extend a loan to that customer. These conflicts of course are multiplied where a bank takes commercial paper issued by one of its customers and sells it to yet another of its customers. In each instance the bank's role as an impartial source of credit is compromised by its role as a marketer.

43 Handal, *The Commercial Paper Market and the Securities Act*, 39 U. Chi. L. Rev. 362, 376-77 (1972). *See also* Securities and Exchange Commission, *The Financial Collapse of the Penn Central Company* (Aug. 1972).

III.

THE MAJORITY BELOW IMPROPERLY DEFERRED TO AN INCORRECT ADMINISTRATIVE DETERMINATION OF A PURELY LEGAL ISSUE

Reversing the District Court because it had supposedly given "insufficient weight" to the Board's expertise (226A), the majority below reached its conclusions "taking account of appropriate deference to the Board's expertise and administrative responsibility." (230A.) The majority defined its task as simply reviewing whether the Board's interpretation was "sufficiently reasonable" (227A). In so doing, the majority opinion raises fundamental questions concerning the judiciary's responsibility "to construe the language employed by Congress,"[44] and to enforce the separation of commercial banking from investment banking that Congress intended.

The majority opinion simply ignored this Court's direction in *Federal Election Comm'n* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 31 (1981), that discussion of judicial deference to an administrative agency is "pointless" where, as here, an agency action "violate[s] the plain language of the Act as well as the statutory purposes revealed by legislative history."

The majority reasoned that the Board should be free to apply "general, undefined statutory terms" to "new facts". (228A.) Rather than being "undefined," however, the terms here are broad and self-defining. Also, the only "new facts" discussed have nothing to do with the instruments described by the terms ("notes" and "securities"), but exclusively concern the banks' new *use* of the instruments described. Commercial paper itself has been around for decades, and was well known

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44 *Zuber* v. *Allen*, 396 U.S. 168, 193 (1969); *Federal Maritime Comm'n* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 745-46 (1973); *Espinoza* v. *Farah Mfg. Co.*, 414 U.S. 86, 93-95 (1973).

to Congress when it drafted the Act broadly to include "notes or other securities".[45]

The majority further stated that the Board "exercises broad rulemaking and adjudicative powers" and has "expert knowledge of commercial banking." (227A.) But, as discussed (*supra*, pp. 22-24), the Board has *no* rulemaking authority under the Glass-Steagall Act to permit securities underwriting by banks. And the Board "defined" the unambiguous statutory terms, not on the basis of matters within its expertise, but by resort to legislative history and the canons of statutory construction—matters within the unique expertise of the *judiciary*.[46] As the District Court below stated, the Board's decision resolved a purely legal issue resting "on inquiries familiar to all courts." (205A.) Under our system,

> the courts are the final authorities on issues of statutory construction. They *must* reject administrative constructions of the statute, whether reached by adjudication or by rule-making, that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement.[47]

The opinion below, if allowed to stand, will almost certainly signal to lower courts and federal regulators an abdication of the judiciary's role to prevent the administrative dismantling of this fundamental statute. In the face of congressional refusal to modify the Glass-Steagall Act restrictions,[48] federal banking

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45 *See supra*, pp. 17-20.

46 *Barlow* v. *Collins*, 397 U.S. 159, 166 (1970).

47 *Federal Election Comm'n* v. *Democratic Senatorial Campaign Comm., supra*, 454 U.S. at 31 (emphasis supplied). *See also*, *American Ship Bldg. Co.* v. *NLRB*, 380 U.S. 300, 318 (1965) (resort to deference "cannot be allowed to slip into a judicial inertia in the unauthorized assumption by an agency of major policy decisions properly made by Congress").

48 *See supra*, pp. 26-27.

regulators have been under intense pressure from the institutions they regulate to relax unilaterally the previously recognized limits on bank activities.[49] Absent action by this Court, bank regulators are likely to continue assuming policy decisions of enormous economic significance that should properly be addressed only by Congress. It is therefore particularly important to reaffirm that "there are limits. . . on how far an agency may go in its interpretive role," and that deference cannot substitute for the judicial "obligation to honor the clear meaning of a statute, as revealed by its language, history and purpose." *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 & n.20 (1979).

CONCLUSION

The majority opinion should be reversed and the Board's ruling, as well as its guidelines implementing that ruling,[50]

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49 For example, the Comptroller of the Currency has repudiated his long-standing construction of the Glass-Steagall Act and ruled that national banks may establish subsidiaries to offer securities brokerage. *Decision of the Comptroller on the Application of Security Pacific National Bank* (Aug. 26, 1982). The Federal Deposit Insurance Corporation has proposed new rules to permit brokerage and underwriting activities by affiliates of the 9,000 state chartered banks under its jurisdiction. 47 Fed. Reg. 38984 (Sept. 3, 1982). And, The Federal Home Loan Bank Board has authorized the first nationwide joint venture by federally chartered savings and loan associations in approving a thrift-sponsored brokerage and investment advisory firm. *Decision of the FHLBB on the Service Corporation Application of Coast Federal Savings & Loan Association, et al.* (May 6, 1982). These decisions are now being challenged in the federal courts. *See*, *Securities Industry Ass'n* v. *Conover*, No. 82-2865, Slip Op. (D.D.C. Nov. 2, 1983); *Investment Company Institute* v. *United States*, No. 82-2532 (D.D.C. filed Sept. 8, 1982); *Securities Industry Ass'n* v. *Federal Home Loan Bank Board*, No. 82-1920 (D.D.C. filed July 12, 1982).

50 As the majority below put it: "[B]ecause the guidelines in essence describe Bankers Trust's activities, it would be difficult to reconcile those guidelines with the district court's holdings." (226A, n.17.)

should be declared null and void and the Board directed to act accordingly.

Dated: New York, New York
November 17, 1983

Respectfully submitted,

James B. Weidner
(Counsel of Record)
John M. Liftin
David A. Schulz
ROGERS & WELLS
200 Park Avenue
New York, New York 10166
(212) 878-8000
Attorneys for Petitioner
Securities Industry Association

Of Counsel:

William J. Fitzpatrick
Securities Industry Association
120 Broadway
New York, New York 10271
(212) 608-1500

Donald J. Crawford
Securities Industry Association
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20024
(202) 488-4664

No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF PETITIONER A. G. BECKER INCORPORATED

HARVEY L. PITT*
(*Counsel of Record)
HENRY A. HUBSCHMAN
DAVID M. MILES

FRIED, FRANK, HARRIS, SHRIVER & KAMPELMAN
(A Partnership Including Professional Corporations)
Suite 1000
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 342-3500

Counsel for Petitioner
A. G. Becker Incorporated

Of Counsel:

STEVEN M. LOONEY
General Counsel
A. G. BECKER INCORPORATED
55 Water Street
New York, New York 10041
(212) 747-6194

LAURENCE H. TRIBE
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4621

November 17, 1983

QUESTIONS PRESENTED

This case seeks review of an unprecedented judicial delegation of administrative authority under the Glass-Steagall Act, one of the primary federal statutes governing the basic structure of the financial services industry in this country. This statute, enacted as a result of the national banking crisis fifty years ago, prohibits banks flatly and entirely from underwriting any corporate "notes or other securities." The specific questions presented are:

1. Did the majority below err in holding that the Federal Reserve Board is free to "adapt" the flat prohibitions of the Glass-Steagall Act on a "case-by-case basis" to the Board's own subjective view of "current business reality" and the "changing financial needs of our economy," when Congress itself has repeatedly refused to grant any exemptive or rulemaking authority over the Act's flat prohibition to any administrative agency?

2. Did the majority below err in endorsing a ruling of the Federal Reserve Board that allows banks to underwrite corporate commercial paper notes, when even the Board concedes that such notes are within the plain language of the Glass-Steagall Act and when this Court repeatedly has instructed that the language of this particular Act is to be construed broadly and applied literally?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1766

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Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF PETITIONER A. G. BECKER INCORPORATED

OPINIONS BELOW

The opinion of the United States Court of Appeals for the District of Columbia Circuit (J.A. 220-257)[1] is reported at 693 F.2d 136. The decisions of the United States Court of Appeals for the District of Columbia Circuit denying, by a split vote, a joint petition for rehearing (J.A. 258) and a suggestion for rehearing *en banc* (J.A. 260) are unreported.

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[1] Material printed in the Joint Appendix is cited as "(J.A.   )".

The opinion of the United States District Court for the District of Columbia granting summary judgment in favor of petitioners A. G. Becker Incorporated ("A. G. Becker") and the Securities Industry Association ("SIA") (J.A. 194-219) is reported at 519 F. Supp. 602. The administrative determination of the Board of Governors of the Federal Reserve System (the "Board") (J.A. 122-143) is unreported. The Board subsequently issued guidelines "Concerning the Sale of Third Party Commercial Paper by State Member Banks" (J.A. 183-189). These guidelines are reported at 46 Fed. Reg. 2933 (June 1, 1981).

JURISDICTION

The judgment of the United States Court of Appeals for the District of Columbia Circuit was entered on November 2, 1982. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on February 2, 1983. A timely petition for a writ of certiorari was granted on October 3, 1983. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This action centers around two sections of the Glass-Steagall Act (the "Act").[2] Section 16 of the Act provides, in pertinent part, that "[commercial banks] shall not underwrite any issue of securities or stock * * *."

[2] Often referred to as the Glass-Steagall Act, the Banking Act of 1933, 48 Stat. 162, is codified in various sections throughout Title 12 of the United States Code. Sections 16 and 21 of the Act are set forth, respectively, in 12 U.S.C. §§ 24 (Seventh) and 378. By its terms, Section 16 applies only to national banks; this provision, however, is made applicable to state member banks of the Federal Reserve System, such as Bankers Trust Company, by Section 5(c) of the Glass-Steagall Act, 12 U.S.C. § 335. Section 21 by its terms applies to any institution that receives deposits.

Section 21 of the Act provides, in pertinent part:

> [I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor * * * .

STATEMENT OF THE CASE

In 1978, Bankers Trust Company ("Bankers Trust") decided to test the flat prohibition of the Glass-Steagall Act, forbidding commercial banks to underwrite "notes or other securities," by attempting to become the first commercial bank to engage in the business of underwriting third-party commercial paper. To accomplish this goal, Bankers Trust commenced an aggressive oral and written promotional campaign, designed to convince corporations to retain the bank to market and distribute their commercial paper through the bank, rather than utilizing securities dealers, as these corporations theretofore invariably had done (J.A. 39-73). Effectively conceding the fact that it had crossed the line dividing the activities of securities broker-dealers from commercial banks, Bankers Trust's promotional materials emphasize the bank's access to a wider range of investors than "*other*" "commercial paper dealers" (J.A. 40, 43) (emphasis supplied).[3]

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[3] Bankers Trust's promotional materials make clear that the bank has assumed the role of a securities underwriter. They boast of a sales distribution system "which rivals that of dealers" and which can "expand your commercial paper sales in a way that our competitors (either bank or dealer) cannot" (J.A. 41-42). The materials also go to great lengths to persuade corporate issuers that the bank's underwriting fee is "competitive with that of commercial paper dealers" (J.A. 40).

In response, A. G. Becker—one of the nation's largest commercial paper dealers—and the SIA—the securities industry's trade association—separately petitioned the Board to declare that Bankers Trust's commercial paper underwriting activities violate the Glass-Steagall Act. A. G. Becker, the SIA, and Bankers Trust all submitted briefs to the Board addressing the legal issues raised by the petitions. Upon the request of the Board, the Securities and Exchange Commission (the "SEC") submitted three legal memoranda to the Board, noting the interrelated structure of the federal securities laws and the Glass-Steagall Act, and expressing the SEC's legal opinion that commercial paper is a "note or other security" for purposes of the Glass-Steagall Act (J.A. 78-90, 91-98, 103-104).

A. The Board's Decision

The Board held that, "as a legal matter, * * * commercial paper is not a '[note or other] security' within the intendment of the Glass-Steagall Act" (J.A. 126). Although the Board admitted that commercial paper constitutes "notes," and conceded that the Act expressly prohibits banks from underwriting "notes," the Board nonetheless concluded that the statute "should not be interpreted according to its literal sense" (J.A. 131). The Board instead purported to adopt a "functional" analysis which, ignoring the bank's role in the distribution of these notes, concluded that the underwriting of these notes by banks could be analogized to a commercial bank loan and therefore should not be treated as a prohibited bank activity (J.A. 134-136).

The Board's ruling, however, also recognized that "potential[ly] unsafe or unsound" practices might proliferate if banks generally were to begin dealing in commercial paper (J.A. 141). The Board accordingly issued guidelines to regulate the underwriting of commercial paper by all state members banks of the Federal Reserve System (J.A. 186-189), while admitting at the same time that the guidelines could only "minimize the danger[s]" that concededly would flow from the commercial

paper underwriting activities the Board had sanctioned (J.A. 185).[4] The Board's ruling thereby not only permitted one bank to engage in these marketing activities, but authorized, and, in effect, encouraged, all member banks to do likewise.[5]

After the Board issued its ruling, A. G. Becker commenced judicial review proceedings under the Administrative Procedure Act, 5 U.S.C. §§ 701, *et seq.*, before the United States District Court for the District of Columbia, challenging the ruling as contrary to law. A similar action brought by the SIA was consolidated with A. G. Becker's lawsuit.

B. The District Court Decision

On cross-motions for summary judgment, the District Court (Joyce Hens Green, J.) held that commercial paper, which by the Board's own admission constitutes notes, falls squarely within the flat prohibition of Sections 16 and 21 of the Act, forbidding banks to underwrite corporate "notes" and "securities." The District Court rejected the Board's position that the Board could narrow the express statutory prohibitions contained in the Act, noting that "[t]he statute *** leav[es] no room for administrative amendment" (J.A. 214; 519 F. Supp. at 614).

The District Court also rejected the Board's "functional" argument that commercial paper, because of its relatively short maturity, the nature of its purchasers, as well as other non-bank

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[4] The guidelines state that member banks should limit their underwriting activities to commercial paper which is exempt from registration under the Securities Act of 1933. The guidelines also provide that member banks should market such commercial paper only to sophisticated investors (a term undefined in the guidelines), and only in large denominations (J.A. 187).

[5] The Board's unprecedented ruling had an immediate impact on the interrelated regulatory systems governing this nation's financial markets. *See, e.g.*, FERC, Order in Docket No. EL 81-5-000, March 27, 1981, 46 Fed. Reg. 19,980 (April 2, 1981) (J.A. 171-181) (issuing a temporary blanket exemption from certain provisions of the Federal Power Act because of the "abrupt change" caused by Board's ruling); SEC, Public Utility Holding Company Act Release No. 35-21967 (March 18, 1981), 46 Fed. Reg. 18,535 (March 25, 1981) (providing exemptions from provisions of the Public Utility Holding Company Act).

related factors, functioned more as a commercial loan than as a security. That analysis was fundamentally incorrect, the District Court declared, because it "ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account * * * or purchases for future sale to an outside party or arranges a transaction between purchaser and seller" (J.A. 217; 519 F. Supp. at 615).

Holding the Board's ruling to be contrary to law, the District Court concluded that the Board had improperly redrawn the Congressionally-mandated boundary between commercial and investment banking (J.A. 218; 519 F. Supp. at 616):

> [T]he Board should refrain from unique and heretofore unprecedented interpretations of the 1933 Glass-Steagall Act which cast such a long shadow as does the Board's ruling on the Becker and SIA petitions. The realignment of our nation's financial industries is for the elected representatives of our nation to bring to fruition by comprehensive legislation, and not for fiat by judicial decree or by administrative policymaking.

C. The Court of Appeals Decision

In a split decision, the Court of Appeals reversed the District Court.

1. The Majority Opinion

Although it conceded that the issue presented was purely legal in nature, the majority held that the Board should be free to "adapt" the Glass-Steagall Act, *on a "case-by-case basis,"* according to the Board's view of "current business reality" and "the changing financial needs of our economy" (J.A. 228; 693 F.2d at 141)(emphasis supplied). Despite the broad language of Sections 16 and 21 of the Act, and despite this Court's repeated direction that those terms are *not* to be construed narrowly, the majority concluded that the Board was empowered to accord the statutory language a "narrower meaning" (J.A. 235; 693 F.2d at 144). In the majority's view, the Board's revision of the statutory terms "notes" and "securities" to

include only "instruments for raising capital as part of the permanent financial structure of a corporation," while "implicitly permitting" banks to underwrite all other types of debt instruments (J.A. 236; 693 F.2d at 144), was an appropriate role for an administrative agency to perform.

The majority also addressed the Board's "functional analysis." While recognizing that, in a traditional loan transaction, a bank *purchases* commercial paper, the majority held that the bank here "is simply on the other side of the transaction" (J.A. 246; 693 F.2d at 150). Thus viewing the marketing role of the bank as immaterial, the majority focused instead on certain purported characteristics of commercial paper to conclude that such notes are not likely to give rise to the hazards at which the Glass-Steagall Act was directed (J.A. 247-249; 693 F.2d at 150-151).

The majority held that the Board was free to redefine the terms "notes" and "securities" in the Act so as not to encompass "prime quality commercial paper, of maturity less than nine months, sold in denominations of over $100,000, to financially sophisticated customers rather than to the general public" (J.A. 249; 693 F.2d at 151). Significantly, however, the majority also held that the Board is free to define commercial paper "of smaller denominations, or issued to the general public" (J.A. 250; 693 F.2d at 151) to be a "note" or "security" under the Act, based solely upon the Board's changing assessment of current economic conditions and competitive business considerations.

2. The Dissent

Senior Circuit Judge Robb dissented, finding that "the majority's holding contravenes the fundamental policy of the Glass-Steagall Act" (J.A. 250; 693 F.2d at 152). Judge Robb rejected the functional analysis invented by the Board and adopted by the majority, noting that it ignores the bank's role as a promoter, which is "[t]he critical distinction between commercial banking and investment banking" (J.A. 251; 693 F.2d at 152).

Judge Robb also rejected the majority's focus on factors such as low default rates and sophistication of investors, pointing out that, by "[r]elying on these factors, a bank could transform 'transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks' " (J.A. 252; 693 F.2d at 153). Judge Robb observed that Congress had flatly prohibited bank underwriting of corporate securities "without regard to the likely 'soundness' of the securities which a bank might sell" (J.A. 255; 693 F.2d at 154). As he stressed, the Act "has no provision permitting bank sales of securities which are 'prime quality' or 'very low-risk' " (J.A. 253; 693 F.2d at 153). Judge Robb also found that bank marketing of commercial paper gives rise to precisely the sort of potential abuses and hazards that Congress intended the Glass-Steagall Act to eliminate (J.A. 253-256; 693 F.2d at 153-155).

Finally, Judge Robb disagreed with the majority's attempt to "force a narrow meaning onto the terms of the Act" (J.A. 256; 693 F.2d at 155). In his view, the terms used by Congress —"stocks," "bonds," "debentures," "notes," and "other securities"—are all-encompassing, and were intended to be so.

SUMMARY OF ARGUMENT

1. Faced with overwhelming evidence that the securities activities of commercial banks had precipitated the Stock Market Crash of 1929 and the ensuing Great Depression, Congress enacted the Glass-Steagall Act to exclude depository institutions completely and entirely from the business of underwriting "notes or other securities." Before taking this admittedly drastic step, Congress considered the alternative of permitting banks to continue to engage in the securities business under a system of ongoing federal supervision and *ad hoc* administrative regulation. But, because it determined that the potential hazards that can arise when banks engage in the securities business simply are too subtle and pervasive to control through case-by-case regulation, Congress rejected this alternative in

favor of a broad, flat and self-executing prohibition forbidding banks to underwrite virtually all notes and securities, including commercial paper. Despite repeated efforts by special interest groups over the last fifty years either to repeal the Act or to alter the prohibitory philosophy it embodies, Congress consistently has adhered to its original policy decision.

In upholding the Board's ruling, however, the majority has done what Congress repeatedly has refused to do—it has transformed the Glass-Steagall Act from a prohibitory statute into an *ad hoc* regulatory statute, in direct contravention of Congress' substantive policy choice on the scope of permissible bank securities activities, and in direct conflict with Congress' structural decision as to the manner in which the issue should be resolved by the federal government. Holding that the Board and the other federal banking regulators are empowered to "adapt" the Glass-Steagall Act to their own subjective notions of "current business reality" and the "changing financial needs of our economy," the majority approved the Board's decision to exclude commercial paper from the scope of the Act's flat prohibition and to regulate the resulting dangers through administrative regulations or guidelines. In doing so, the majority not only contravened Congress' unambiguous intent, but impermissibly conferred upon the federal banking regulators virtually unbounded legislative power to restructure the statutory framework governing the nation's financial services industry.

The consequences of this usurpation of legislative authority have been confusion and disruption. In exercising their new found legislative authority, the banking regulators have interfered with and pre-empted an ongoing legislative process, have forced the SEC to reverse its longstanding interpretation of the securities laws in an attempt to cure the resulting regulatory imbalance, and have provoked a torrent of litigation. Because the majority opinion cannot be squared with the language of the Act, the Congressional intent underlying the Glass-Steagall Act, or the separation-of-powers principles embodied in the Constitution, the statutory interpretation it espouses should be reversed.

2. In transforming the Glass-Steagall Act into a regulatory statute, and in extending extreme and undue judicial deference to the Board's "adaptation" of the Act, the majority below abdicated its duty to construe the language of the Glass-Steagall Act. The issue in this case is not whether, in light of a broad Congressional mandate, the Board reasonably exercised delegated regulatory authority in permitting banks to underwrite commercial paper. The issue here is whether commercial paper constitutes "notes or other securities" within the meaning of the flat Congressional prohibition embodied in Sections 16 and 21 of the Glass-Steagall Act—a pure question of statutory construction, which, under Article III of the Constitution and the Administrative Procedure Act, is a matter to be decided by the judiciary. Resolution of this issue turns not upon the Board's expert knowledge of commercial banking, but upon the language and legislative history of the Glass-Steagall Act and upon judicial application of the canons of statutory construction. Because the Board's ruling contravenes the plain language and legislative purpose of the Act, as well as established principles of statutory interpretation, the Board's ruling is not entitled to judicial deference.

3. Sections 16 and 21 of the Glass-Steagall Act flatly prohibit commercial banks from underwriting commercial paper "notes" and "securities." This Court repeatedly has instructed that the terms of Sections 16 and 21 are to be construed broadly and applied literally. As the Board and majority below conceded, application of these principles plainly demonstrates that commercial paper is both a "note" and a "security."

4. The legislative history surrounding the enactment of the Glass-Steagall Act confirms the plain statutory language. Throughout the Glass-Steagall Act, and other contemporaneous legislation enacted in response to the economic crisis of the 1930's, is an express Congressional intent that the words "notes" and "securities" are to encompass commercial paper. Indeed, in those instances where Congress wished to exclude commercial paper from the reach of specific portions of these statutes, Congress itself provided exclusions through express statutory language. Here, Congress did not except commercial

paper "notes" and "securities" from the flat prohibition of the Glass-Steagall Act, either expressly or indirectly. Indeed, the statutory language, structure, and purpose plainly evidence the fact that Congress intended the Act to apply to all notes and securities, regardless of risk, and to apply to commercial paper.

5. For these reasons, the "functional analysis" followed by the Board and adopted by the majority has no place in construing the Glass-Steagall Act, a prohibitory statute which does not provide for case-by-case administrative regulation. Proper application of a functional analysis, however, confirms that commercial paper falls within the scope of the Act's flat prohibition. When a bank markets commercial paper, it is not functioning as a commercial banker by extending commercial loans, but is functioning as an investment banker by promoting the sale of a third party's notes to investors. This is precisely the activity Congress sought to prohibit in enacting the Glass-Steagall Act.

ARGUMENT

I. THE MAJORITY OPINION BELOW IMPROPERLY TRANSFORMS THE GLASS-STEAGALL ACT FROM A SELF-EXECUTING, FLATLY PROHIBITORY STATUTE INTO A STATUTE AUTHORIZING *AD HOC*, CASE-BY-CASE ADMINISTRATIVE REGULATION

A. The Glass-Steagall Act Flatly Prohibits Banks From Underwriting Corporate "Notes or Other Securities"

The Glass-Steagall Act embodies Congress' considered legislative judgment that it was necessary to "separat[e] as completely as possible commercial from investment banking." *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 70 (1981) ("*Board of Governors*"). To achieve this goal, Section 16 of the Glass-Steagall Act unequivocally and directly prohibits commercial banks from "underwriting *any* issue of securities or stock" (emphasis supplied).

Section 21 of the Act, in turn, unambiguously and directly prohibits any firm "engaged in the business of * * * underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities" from "engag[ing] at the same time *to any extent whatever* in the business of receiving deposits * * * " (emphasis supplied). As this Court has observed, "Sections 16 and 21 *flatly prohibit* banks from engaging in the [securities] underwriting business." *Board of Governors, supra,* 450 U.S. at 58 n. 24 (emphasis supplied).[6]

Congress took the drastic step of enacting a "flat prohibition" deliberately. Following the stock market crash and Congressional hearings in which the involvement of banks in securities activities was detailed, Congress considered permitting commercial banks to engage in the securities business under a system of ongoing federal supervision and *ad hoc* administrative regulation.[7] Congress determined, however, that the conflicts of interests, financial dangers and other potential abuses that arise when banks engage in the securities business are "so subtle as not to be easily recognized,"[8] rendering them impervious to case-by-case regulatory control.

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[6] Over the years, Congress has adopted a few limited exceptions to the Act's flat prohibition. But, when Congress has intended exceptions, Congress *itself* has carefully and expressly authorized the activities in question, rather than leaving the matter to any regulatory body. Thus, in 1933, Congress specifically excepted certain governmental securities from the scope of Section 16's underwriting bar. *See* 48 Stat. 162. Similarly, in 1935, Congress amended Section 21 to except mortgage notes from its reach. *See* 49 Stat. 707. And, on several occasions, Congress has amended Section 16 to allow banks to underwrite a variety of "stocks, bonds, debentures, notes or other securities" issued or guaranteed by federal regulatory agencies. *See, e.g.,* 48 Stat. 162.

[7] *See, e.g.,* H. Willis & J. Chapman, *The Banking Situation* 67-69 (1934); W. Peach, *The Securities Affiliates of National Banks* 143-148 (reprinted ed. 1975); *see generally,* 75 Cong. Rec. 9882 (1932) (remarks of Sen. Glass) (explaining difference of opinion in the committee over regulation versus complete separation).

[8] 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *see also, Investment Company Institute* v. *Camp,* 401 U.S. 617, 630 (1971) ("*Camp*") (Congress "repeatedly focused on the more subtle hazards that arise when a commercial bank * * * enters the investment banking business").

and are so fundamentally incompatible with the business of commercial banking as to necessitate the prophylactic remedy of absolute prohibition.[9]

As a result, Congress decided to separate investment and commercial banking "completely" and "entirely," *Board of Governors, supra,* 450 U.S. at 62, notwithstanding the potential costs of this policy, and notwithstanding the increasing popularity, in that era, of delegating broad regulatory discretion to administrative agencies.[10] Thus, as this Court has observed, the Glass-Steagall Act represents Congress' considered legislative judgment that

> policies of competition, convenience, or expertise which might otherwise support the entry of commercial banks into the investment banking business [are] outweighed by the "hazards" and "financial dangers" that arise when commercial banks engage in the activities proscribed by the Act.

Camp, supra, 401 U.S. at 630.[11]

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[9] *See, e.g.,* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley) (mere existence of bank securities operation "no matter how carefully and conservatively run is inconsistent with the best interests of the bank as a whole"); *Camp, supra,* 401 U.S. at 634 (Congress concluded that "the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities [are] destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system").

[10] *See also,* 76 Cong. Rec. 1940 (1933) (remarks of President Roosevelt) ("Investment banking is a legitimate business. Commercial banking is another wholly separate and distinct legitimate business. Their consolidation and mingling is contrary to public policy. I propose their separation"). *Accord,* S. Rep. No. 1455, 73d Cong., 2d Sess. 185 (1934).

[11] The history of Section 21 in particular reveals the strength of Congress' commitment to the Act's flat prohibition. As originally reported from Committee, Section 21 only prohibited those entities "principally engaged" in underwriting securities from accepting deposits. During floor debate on the bill, the Senate approved an amendment striking the word "principally," "in order to make sure that we will accomplish a [complete] separation of

(footnote continues)

Congress has adhered to that judgment ever since, and steadfastly has refused to substitute transitory administrative regulation for flat statutory prohibition. Thus, in 1935, Congress refused to amend the Act to permit "national banks, *under regulation* by the Comptroller of the Currency, to underwrite and sell bonds, debentures, and notes."[12] And, as recently as 1980, Congress extended to the Comptroller of the Currency authority to issue such rules as were needed to "carry out the responsibilities of the office," 12 U.S.C. § 93a, but expressly continued to withhold from the Comptroller the authority to issue regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act.'" *Id.*

The basic policy decision Congress made in enacting the Glass-Steagall Act—a policy decision regarding both the level of government at which, and the substantive form in which, the separation of investment and commercial banking would be addressed—contrasts sharply with the Congressional policy decision embodied in the Bank Holding Company Act, 12 U.S.C. §§ 1841, *et seq.* In the Bank Holding Company Act, Congress deliberately created a regulatory regime, expressly vesting in the Board the power to define and to authorize bank holding companies and their non-bank subsidiaries to undertake those activities the Board properly finds, on a case-by-case basis, to be "so closely related to banking * * * as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8).

As this Court has observed, Congress intended Section 4(c)(8) of the Bank Holding Company Act to confer upon the

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(footnote continued)

investment and deposit banking." *See* 77 Cong. Rec. 4180 (1933) (remarks of Sen. Bulkley). The Senate also considered an amendment to Section 21 designed to permit investment bankers, under limited circumstances, to accept savings deposits. At the urging of Senators Glass and Bulkley, however, the Senate defeated this proposal in order to preserve the Act's "absolute prohibition." *See* 77 Cong. Rec. 4149 (1933).

[12] *See* H.R. Conf. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935)(emphasis supplied); *see also*, S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935); 79 Cong. Rec. 13,706 (1935) (remarks of Rep. Steagall); 79 Cong. Rec. 11,934-11,935 (1935) (remarks of Sen. LaFollette).

Board "flexibility * * * to determine the activities in which a bank holding company and its [non-bank] subsidiaries may engage." *Board of Governors, supra*, 450 U.S. at 57 n. 23 (quoting 116 Cong. Rec. 42,432 (1970)). Congress inserted no comparable delegation of discretionary authority in the Glass-Steagall Act.

Congress' deliberate insistence upon the maintenance of the broad scope of the Act's flat prohibition has been as adamant as its refusal to replace the prohibition with a scheme of administrative regulation. Thus, as explained above (*see* p. *14, supra*), Congress refused in 1935 to grant national banks the precise power the Board purported to grant here—the power to underwrite bonds, debentures, and notes. In 1938, Congress also refused even to report out of committee legislation which would have permitted banks to "underwrite or participate in the underwriting of new issues of such securities as [they] might otherwise lawfully purchase for [their] own account." *See* H.R. 9441, 75th Cong., 3d Sess. (1938); 83 Cong. Rec. 1809 (1938). And, Congress consistently has refused to amend the Act in order to permit banks to engage in a variety of related securities activities.[13]

Despite the current clamor to make wholesale changes in the scope of the Act's prohibitions, Congress has been equally adamant in recent years. For example, during each of its last three terms, Congress considered major legislative proposals which would have materially altered the substantive restrictions of the Glass-Steagall Act. Although Congress enacted major reforms to other federal banking laws in each of those terms,[14]

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[13] *See, e.g.*, H.R. Rep. No. 1631, 91st Cong., 2d Sess. 28-29 (1970) (defeat of bills authorizing banks to underwrite shares in bank mutual funds); S. Rep. No. 184, 91st Cong., 1st Sess. 10-12, 22-28 (1969); S. Rep. No. 1351, 90th Cong., 2d Sess. 9-11, 19-26 (1968); *Hearings on S. 1933 and S. 2474 before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 93rd Cong., 2d Sess. 6, 136 (1974) (noting revenue bond legislation introduced and defeated in 1935, 1938, 1945, 1955, 1957, 1962, 1963, 1965, 1967, 1973, and 1975).

[14] *See* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982); Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (1980); Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 (1978).

Congress in each instance refused to modify the scope of the Glass-Steagall Act restrictions in the slightest.[15]

This history vividly illustrates the serious legal infirmity in the majority's interpretation of the Glass-Steagall Act. This Court has instructed that the judiciary must not "give a reading to [a statute] that Congress considered and rejected." *Pacific Gas & Elec. Co.* v. *State Energy Resources Commission,* 103 S. Ct. 1713, 1730 (1983). *See also, Baldridge* v. *Shapiro,* 455 U.S. 345, 358 (1982). Yet, by transforming the Glass-Steagall Act into a regulatory statute, and by authorizing the Board to "adapt" the Act's terms on a "case-by-case basis" to the *Board's* view of "current business reality" and "the changing financial needs of our economy," the majority has overridden Congress' substantive and structural policy decisions, and improperly has "enacted" the very statute Congress consistently has refused to enact for fifty years.[16]

B. The Interrelated Statutory Scheme Congress Created To Govern The Securities And Banking Industries Confirms That The Glass-Steagall Act Constitutes A Flat Prohibition

The effect of the majority's opinion was to delegate Article I legislative power to the Board, and to invite the Board to exercise that power by adapting the Glass-Steagall Act to the *Board's* changing assessment of current economic conditions and competitive business considerations. The federal banking regulators, in turn, have willingly accepted the majority's invitation, and, within the past year alone, have authorized

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[15] *Compare, e.g.,* S. 1720, 97th Cong., 1st Sess. (1981) (proposing authority for banks to underwrite revenue bonds and mutual funds) *with* Pub. L. No. 97-320, 96 Stat. 1469 (1982) (containing no such authority). *See also, Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs,* 97th Cong., 2d Sess. 6-10 (1982) (testimony of Hon. Donald T. Regan, Secretary of the Treasury).

[16] *See, e.g., Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 732 (1975).

banks to commence, for the first time since the Glass-Steagall Act was adopted fifty years ago, activities previously understood to be barred to banks.[17]

Apart from the deluge of litigation that this administrative exercise of legislative authority has generated,[18] and that it will continue to spawn if the majority opinion were affirmed,[19] the opinion below also has had palpable effects upon the carefully

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[17] *See, e.g., Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas, to Establish an Operating Subsidiary to Provide Investment Advice* (September 6, 1983) (combination of investment advice and brokerage business); *BankAmerica Corp. (Schwab)*, 69 Fed. Res. Bull. 105 (1983) (public securities brokerage); *Decision of the Comptroller of the Currency on the Application by Citibank to Establish Common Trust Funds for the Collective Investment of Individual Retirement Account Trusts* (October 28, 1982) (bank operation of mutual funds); *FDIC Statement of Policy on the Applicability of the Glass-Steagall Act to Securities Activities of Subsidiaries of Insured Non-member Banks*, 47 Fed. Reg. 38,984 (September 3, 1982) (bank underwriting of securities through shell subsidiaries); *Decision of the Comptroller of the Currency on the Application by Security Pacific National Bank to Establish an Operating Subsidiary to be Known as Security Pacific Discount Brokerage Services, Inc.* (August 26, 1982) (public securities brokerage); *Decision of the Federal Home Loan Bank Board on the Service Corporation Application of Coast Federal Savings & Loan Association, Perpetual American Federal Savings & Loan Association and California Savings & Loan Association* (May 6, 1982) (same).

[18] *See, e.g., Investment Company Institute* v. *Conover*, No. 83-0549 (D.D.C. filed Feb. 24, 1983); *Investment Company Institute* v. *United States*, No. 82-2532 (D.D.C. filed Sept. 8, 1982); *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, No. 83-4019 (2d Cir. filed Feb. 3, 1983); *Securities Industry Association* v. *Conover*, No. 82-2865 (D.D.C. filed Oct. 6, 1982); *Securities Industry Association* v. *Federal Home Loan Bank Board*, No. 82-1920 (D.D.C. filed July 12, 1982).

[19] By deliberately structuring the Glass-Steagall Act as a flat prohibition against bank underwriting of all "stocks, bonds, debentures, notes, or other securities," and by then excepting from the reach of the prohibition those limited activities it intended to authorize, Congress eliminated the need for continuous administrative proceedings, followed by continuous judicial review proceedings, to define the scope of permissible bank securities activities. Because the majority opinion eviscerates Congress' structural prohibition in favor of *ad hoc* adaptation and administrative regulation, however, affirmance of the majority opinion would *institutionalize* litigation as the key determinant of permissible bank securities activities, particularly since the banking regulators will be forced to "adapt" their "adaptations" of the statute to constantly changing business conditions.

balanced and intertwined statutory scheme Congress legislated to govern the securities and banking industries. Thus, for example, because Congress believed that the Glass-Steagall Act flatly foreclosed banks from engaging in the securities business, Congress excepted banks from the definitions of the terms "broker" and "dealer" in the Securities Exchange Act of 1934.[20] These exclusions, of course, place banks outside the comprehensive regulatory scheme Congress created to protect investors, to govern the nation's securities markets, and to vest in the SEC "reasonably complete and effective control" over the participants in those markets. 15 U.S.C. § 78b.

Because of the recent rulings of the federal banking regulators, however, the SEC has deemed it necessary to attempt itself to realign the statutory structure by removing the statutory exception for banks from SEC jurisdiction that Congress wrote into the statute.[21] Such a requirement, deemed necessary by the SEC to protect investors who purchase their securities and notes from banks instead of securities brokers and dealers, will surely spawn additional litigation by banks, and has produced an unseemly confrontation between the SEC and various banking regulators.[22]

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[20] *See, e.g., Hearings on H.R. 7852 and H.R. 8720 before House Comm. on Interstate & Foreign Commerce*, 73d Cong., 2d Sess. 86 (1934) (Testimony of Thomas G. Corcoran) ("[U]nder the Glass-Steagall bill [, banks] cannot go into a business of dealing in securities"). *See also*, H.R. Rep. No. 123, 94th Cong., 1st Sess. 93 (1975) ("Since 1934, banks have been excluded from the definition of 'broker' and 'dealer' under the Securities Exchange Act. * * * the Glass-Steagall Act had effectively removed banks from the securities business").

[21] *See* 48 Fed. Reg. 51,930 (November 15, 1983). ("This action is prompted by investor protection *and other regulatory concerns raised by the recent expansion of bank securities activities"*) (emphasis supplied).

[22] *See Banks' Stock Business Controls Voted by SEC*, The Washington Post, October 28, 1983 at D.10; *SEC To Propose Registering Banks That Solicit Securities Business*, 15 BNA Sec. Reg. L. Rep. 1995 (October 28, 1983); *SEC Rush on Turf Ruffled Regulators at Bank Agencies*, Legal Times, November 14, 1983 at 1.

In short, the banking regulators' exercise of their new-found authority to "adapt" the Glass-Steagall Act has triggered a veritable flood of additional revisionist regulatory activity, inflicting serious damage upon the fabric of the law. Congress' decision to separate the securities and banking industries has been disregarded. The carefully balanced and integrated statutory scheme Congress created to govern the industries it had separated has been replaced with a patchwork regulatory quilt of uncertain and constantly varying shape, and of growing size. The results have been increased litigation, business uncertainty and administrative disarray.

These costs are all perhaps part of the price that must be paid when Congress, in the exercise of its Article I powers, *deliberately* delegates to an administrative agency the authority to regulate, on a case-by-case basis, a problem that Congress itself has determined to be too fluid, too complex, or too broad-ranging to resolve through comprehensive yet specific legislation. *See, e.g.*, R. Stewart, *Reformation of American Administrative Law*, 88 Harv. L. Rev. 1667, 1695-1696 (1975). The Glass-Steagall Act, however, is not a statute in which Congress has delegated a problem, along with Congress' legislative authority, to the headless "fourth branch of * * * [g]overnment" for resolution. *INS* v. *Chadha*, 103 S. Ct. 2764, 2801 (1983) (White J., dissenting). In enacting the Glass-Steagall Act, Congress itself surveyed the problems presented by banks' securities activities, considered the potential benefits of a regulatory approach, and deliberately rejected that approach in favor of a broad and flat prohibition. Under such circumstances, it was completely at odds with our system of government for the majority to disregard Congress' legislative solution and to substitute in its place, along with all the attendant costs, the majority's own gratuitous contribution to the "modern administrative state." *Id.* at 2810.

When all is said and done, the fact remains that no administrative agency possesses the inherent power to "adapt" a statute to its subjective notions of "the changing financial

needs of our economy," and no court has the authority to vest such power in an agency.[23] Even if an agency deems a statute to be outdated, anachronistic, or unwise, its duty, under our system of government, is to enforce the statute unless and until it is repealed by Congress:

> Our system of government is, after all, a tripartite one, with each branch having certain defined functions delegated to it by the Constitution. * * * [I]t is * * * the exclusive province of the Congress not only to formulate legislative policies and mandate programs and projects, but also to establish their relative priority for the Nation. *Once Congress * * * has decided the order of priorities in a given area, it is for the Executive to administer the laws and for the courts to enforce them when enforcement is sought.*

TVA v. *Hill,* 437 U.S. 153, 194 (1978) (emphasis supplied). *See also, Office Employees International Union* v. *NLRB,* 353 U.S. 313, 319 (1957). Because the majority opinion is unfaithful to these principles, the statutory interpretation it espouses should be reversed.

II. THE MAJORITY OPINION BELOW IMPROPERLY AUTHORIZES BANKS TO UNDERWRITE COMMERCIAL PAPER "NOTES" AND "SECURITIES"

A. The Majority Below Abdicated Its Duty To Construe The Language Of The Glass-Steagall Act

That the majority improperly has transformed the Glass-Steagall Act into a regulatory statute is evidenced by the standard of review it applied. The majority held that it was not required to determine what Congress intended when it enacted

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[23] Because Congress indisputably has not delegated such power to the Board, there is no need for this Court to consider the serious constitutional issues that would be presented by such a wholly open-ended and amorphous delegation. *See, e.g., Schechter Poultry Corp.* v. *United States*, 295 U.S. 495 (1935); *Panama Refining Co.* v. *Ryan*, 293 U.S. 388 (1935); *Industrial Union Dept.* v. *American Petroleum Institute*, 448 U.S. 607, 671-688 (1980) (Rehnquist, J., concurring in the judgment); *American Textile Mfrs. Institute, Inc.* v. *Donovan*, 452 U.S. 490, 543-548 (1981) (Rehnquist, J. and Burger, C.J., dissenting).

the Glass-Steagall Act and was not empowered to determine whether the Board had correctly interpreted the Act, but rather was restricted to ascertaining whether the Board's ruling somehow was "'sufficiently reasonable' to be accepted by a reviewing court" (J.A. 227; 693 F.2d at 140)(emphasis omitted). As its rationale for this standard of review, the majority stated that the Board, and not the Congress, is best suited to "formulate national banking policy" under the Act, in the light of the Board's "broad rulemaking * * * powers" and its "expert knowledge" of the commercial banking industry (J.A. 227; 693 F.2d at 140) (emphasis omitted).

Contrary to the majority opinion, however, the issue in this case is not whether the Board reasonably exercised delegated regulatory authority in permitting banks to underwrite commercial paper, or which branch of government is best suited to formulate national banking policy. The issue is whether *Congress*—the branch that already and properly has formulated that policy—intended to prohibit banks from underwriting commercial paper when it forbade them to underwrite "notes or other securities." As the district court recognized (J.A. 208; 519 F. Supp at 611), this issue presents a pure question of statutory construction which, under Article III of the Constitution[24] and the Administrative Procedure Act,[25] is entrusted to the judiciary for resolution.

As a result, the Board's nonexistent rulemaking powers under the Act,[26] and its "expert knowledge" of commercial

[24] *See, e.g., Marbury* v. *Madison*, 5 U.S. 137, 177 (1803); *United States* v. *Nixon*, 418 U.S. 683, 705 (1973).

[25] The Administrative Procedure Act directs that the *court* shall "decide all relevant questions of law, interpret constitutional and statutory provisions" and "hold unlawful and set aside agency action * * * not in accordance with the law." 5 U.S.C. § 706.

[26] The Board's "rulemaking" power to which the majority mistakenly referred is found in *other* banking statutes, *see* 12 U.S.C. § 1843(c)(8), but *not* in the Glass-Steagall Act (J.A. 227; 693 F.2d at 140). The majority was unable to cite any grant of rule-making power to the Board in the Glass-Steagall Act because Congress repeatedly has refused to grant such rule-making power. *See* pp. 12-14, *supra*.

banking, simply have no relevance here. Rather, because the instant controversy

> relates to the meaning of * * * statutory term[s], the controversy must ultimately be resolved, not on the basis of matters within the special competence of the [Board], but by judicial application of canons of statutory construction.

Barlow v. *Collins*, 397 U.S. 159, 166 (1970) (citing *Texas Gas Transmission Corp.* v. *Shell Oil Co.*, 363 U.S. 263, 268-270 (1960)). In this area, it is the courts, and not administrative agencies, which are the "expert[s]." *Barlow* v. *Collins, supra*, 397 U.S. at 166 (quoting *Hardin* v. *Kentucky Utilities Co.*, 390 U.S. 1, 14 (1968) (Harlan, J., dissenting)).[27]

To be sure, courts generally will extend judicial deference to a reasonable interpretation of a statute propounded by an agency entrusted with the statute's administration. *See Camp, supra*, 401 U.S. at 426-427. Here, however, there is no such regime because the Glass-Steagall Act is a self-enforcing criminal statute. Moreover, even if the principal of judicial deference has any relevance here, it "only sets 'the framework for judicial analysis; it does not displace it.'" *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973)). Within this

[27] In deferring to the Board's expert knowledge of commercial banking, the majority erroneously relied heavily upon Justice Rutledge's concurring opinion in *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450-451 (1947) (Rutledge, J., concurring) ("*Agnew*"). In *Agnew*, seven members of this Court expressly rejected the extremely deferential standard of review proposed by Justice Rutledge, stressing that it is the judiciary's obligation to construe the Act's flat prohibition. *See Agnew, supra*, 329 U.S. at 449. And, this Court has rejected Justice Rutledge's standard of review in subsequent cases construing the Glass-Steagall Act. *See Camp, supra*, 401 U.S. at 426-427.

In contrast, this Court has cited Justice Rutledge's concurrence in defining the standard of review applicable *under the Bank Holding Company Act. See Board of Governors, supra*, 450 U.S. at 56 n. 21. But, the Bank Holding Company Act, unlike the Glass-Steagall Act, is a regulatory statute, and the Board's knowledge of commercial banking is relevant in discerning, under Section 4(c)(8) of the Bank Holding Company Act, those activities that are "closely related to banking." The same plainly is not true in determining whether Congress intended the phrase "notes or other securities" to encompass commercial paper.

framework, the courts are obliged strictly to scrutinize the agency's interpretation,[28] and to reject the interpretation when it clashes with the plain language,[29] legislative history,[30] or purpose of the statute.[31] As this Court recently reaffirmed:

> [T]he courts are the final authorities on issues of statutory construction. They *must* reject administrative constructions of the statute, whether reached by adjudication or by rule-making that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement.

FEC v. *Democratic Senatorial Campaign Committee,* 454 U.S. 27, 32 (1981) (emphasis supplied). *Cf. Motor Vehicles Manufacturers Association* v. *State Farm Mutual Automobile Insurance Co.,* 103 S. Ct. 2856, 2866-2867 (1983).[32]

In transforming the Glass-Steagall Act from a prohibitory into a regulatory statute, the majority failed to adhere to these principles. Rather than recognizing its "obligation to honor the clear meaning of the statute, as revealed by its language, purposes, and history," *International Brotherhood of Teamsters* v. *Daniel, supra,* 439 U.S. at 556 n. 20, the majority abdicated its responsibility and extended unprecedented judicial deference to the Board's "adaptation" of the Glass-Steagall Act.

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[28] *See, e.g., Southeastern Community College* v. *Davis,* 442 U.S. 397 (1979); *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551 (1979).

[29] *See, e.g., SEC* v. *Sloan,* 436 U.S. 103, 117-118 (1978).

[30] *See, e.g., FMC v. Seatrain Lines, Inc.,* 411 U.S. 726, 736-744 (1973).

[31] *See, e.g., Morton* v. *Ruiz,* 415 U.S. 199, 237 (1974).

[32] The majority's reliance upon the *Democratic Senatorial Campaign Committee* case in adopting its standard of review is further evidence of the majority's transformation of the Glass-Steagall Act into a regulatory statute. In that case, this Court upheld a regulation promulgated under the Federal Election Campaign Act of 1971 because the regulation contravened neither the language nor the purpose of the statute, and because Congress had vested in the Federal Election Commission the power to "formulate general policy" under the Act through "extensive rulemaking * * * powers." *FEC* v. *Democratic Senatorial Campaign Committee, supra,* 454 U.S. at 37. Congress, of course, expressly has declined to vest such regulatory authority in the Board under the Glass-Steagall Act. And, as demonstrated below, the Board's ruling contravenes *both* the plain language and purpose of the Glass-Steagall Act.

In doing so, the majority also improperly permitted the Board to arrogate to itself a policy decision of enormous economic and legal significance, notwithstanding this Court's warning that:

> [t]he deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia which results in the unauthorized assumption by an agency of major policy decisions properly made by Congress.

American Ship Building Co. v. *NLRB*, 380 U.S. 300, 318 (1965); *Cf. Office Employees International Union* v. *NLRB*, *supra*, 353 U.S. at 319; *SEC* v. *Sloan*, *supra*, 436 U.S. at 118-122.

In sum, the sole, narrow question before the majority was whether Congress intended the flat prohibition of the Glass-Steagall Act to encompass commercial paper. As demonstrated below, the plain language, legislative history, and structure of the statute establish plainly that it did. As a result, talk of deference to the Board's contrary ruling simply is "pointless." *FEC* v. *Democratic Senatorial Campaign Committee*, *supra*, 454 U.S. at 31.

B. Commercial Paper Is A Note or Other Security Under The Plain Statutory Language

Section 16 of the Glass-Steagall Act flatly prohibits banks from underwriting any issue of "securities or stock." In parallel fashion, Section 21 of the Act flatly prohibits any entity engaged in the underwriting of "stocks, bonds, debentures, notes, or other securities" from simultaneously accepting deposits. Because the reach of Sections 16 and 21 are coextensive,[33] the issue before this Court, simply stated, is whether Congress intended the phrase "notes or other securities" to encompass commercial paper.

The principles governing the resolution of this issue are equally simple and well-settled. As this Court recently explained:

> [I]n all cases involving statutory construction, "our starting point must be the language employed by

[33] *See Board of Governors*, *supra*, 450 U.S. at 63. *See also*, (J.A. 212; 519 F. Supp. at 613).

> Congress." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 337 (1979), and we assume "that the legislative purpose is expressed by the ordinary meaning of the words used." *Richards* v. *United States*, 369 U.S. 1, 9 (1962). Thus, "[a]bsent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

American Tobacco Co. v. *Patterson*, 456 U.S. 63, 68 (1982).

These principles apply with special force in interpreting the Glass-Steagall Act, where this Court has directed that the "literal terms" of the Act are to be applied "as they were written." *Camp, supra*, 401 U.S. at 639. Indeed, this Court only recently has reiterated that the courts must "rely[ ] squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act." *Board of Governors, supra*, 450 U.S. at 65.

Application of these principles establishes that commercial paper falls squarely within the Act's flat prohibition. Sections 16 and 21 forbid banks to underwrite "notes or other securities." It is beyond dispute, as even the Board[34] and the majority below[35] concede, that commercial paper constitutes "notes." Indeed, this concession is mandated not only by the numerous explicit references in the banking statutes to commercial paper as "notes" and to "notes" as commercial paper,[36] but also by the express statements of the drafters of the Glass-Steagall Act.[37]

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[34] ("[C]ommercial paper * * * consists of unsecured promissory *notes*") (J.A. 131) (emphasis supplied); ("While the words in statutes should generally be interpreted in light of their ordinary meaning, it is clear for a number of reasons that the term 'notes' as used in Section 21 should not be interpreted according to its literal sense") (J.A. 131).

[35] (J.A. 233; 693 F.2d at 143).

[36] *See, e.g.*, 12 U.S.C. § 84 (exempting from limitations on the amount of money a national bank can lend to any one person obligations as indorser or guarantor of *notes, other than commercial or business paper).*

[37] *See, e.g.*, 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott) (decrying the pre-panic practice in which business deviated from "borrowing at the commercial banks upon their commercial paper—that is upon their *notes*") (emphasis supplied).

Commercial paper also is a "security" under the plain language of the Glass-Steagall Act. Sections 16 and 21 prohibit banks from underwriting "stocks, bonds, debentures, notes, *or other securities*" (emphasis supplied). As Judge Robb (J.A. 256-257; 693 F.2d at 155) and the district court (J.A. 212; 519 F. Supp. at 613) held, the juxtaposition of the terms "notes" and "*other* securities" demonstrates that commercial paper "notes" are included within the generic definition of the broader term "securities." Indeed, were this not so, the word "other" in the phrase "other securities" impermissibly would be rendered superfluous.[38] In short,

> [T]here is nothing in the phrasing of either § 16 or § 21 that suggests a narrow reading of the word "securities". To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Camp, supra, 401 U.S. at 635.

The majority below took a radically different approach to the statutory language in order to exclude commercial paper from its reach. Rather than construing the language broadly and applying it literally, as this Court has instructed, the majority determined that the statute should be given a "narrower meaning" than that expressed by its plain language (J.A. 235; 693 F.2d at 144).

The majority reasoned that, because "stocks," "bonds," and "debentures" allegedly all are instruments issued "to raise money for an extended period of time as part of a corporation's capital structure," Congress must have intended the term "notes" to include only similar types of notes. Thus, the majority deleted the term "notes" from the statute and replaced it with the heretofore unknown term "investment notes" (J.A. 234; 693 F.2d at 143) or, stated differently, notes issued "to

[38] *See, e.g., Reiter* v. *Sonotone Corp.,* 442 U.S. 330, 339 (1979) ("In construing a statute we are obliged to give effect, if possible, to every word Congress used"). *Accord, Colautti* v. *Franklin,* 439 U.S. 379, 392 (1979); *Weinberger* v. *Hynson, Wescott and Dunning, Inc.,* 412 U.S. 609, 633 (1973); *United States* v. *Menasche,* 348 U.S. 528, 538-539 (1955); C. Sands, *Sutherland's Statutory Construction* § 46.06 (3d ed. 1973).

raise money available for an extended period of time as part of a corporation's capital structure" (J.A. 233; 693 F.2d at 143). And, because the majority found commercial paper to fall outside the rewritten statutory language, the majority concluded that the Glass-Steagall Act does not apply to commercial paper.

The majority's narrow construction of the statutory language, however, does not withstand analysis. Congress long has been aware of the distinctions between various types of notes, and has qualified the term "notes" when it has deemed use of a qualifier appropriate.[39] Section 21, however, contains no adjectives and draws no distinctions; it refers simply and comprehensively to *all "notes."*[40]

Moreover, Congress' own actions demonstrate that Congress intended the term "notes" in Section 21 to have its plain and ordinary meaning. When Congress decided, in 1935, to exclude "mortgage notes" from the coverage of Section 21, Congress itself amended the statutory language in order to do so.[41] This amendment would have been unnecessary and

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[39] Thus, Section 16 of the Glass-Steagall Act (12 U.S.C. § 24 (Seventh)) refers to "notes * * * commonly known as investment securities"; Section 9 of the Federal Reserve Act (12 U.S.C. § 320) refers to "capital notes"; and Section 13 of the Federal Reserve Act describes "national bank notes," "Federal Reserve Notes," and "maturing notes" (12 U.S.C. § 342), while distinguishing between "notes * * * issued or drawn for agricultural, industrial, or commercial purposes" and "notes * * * covering merely investments" (12 U.S.C. § 343).

[40] The majority's attempt to create a distinction between bonds and debentures on the one hand, and commercial paper on the other, does not square with economic reality. "Bonds" and "debentures" never have been used solely as long-term capital raising instruments, either now or in 1933. (The Supplemental Appendix to this brief contains, for the Court's convenience, several tombstones for bonds and debentures with maturities of nine months or less, from both the period in which the Glass-Steagall Act was enacted (1930-1935) and from the present). Conversely, commercial paper often is used as a long-term capital raising device. *See, e.g.*, J.W. Hicks, *Commercial Paper: An Exempted Security Under Section 3(a)(3) of the Securities Act of 1933*, 24 U.C.L.A. L. Rev. 227, 281-292 (1976); K. Handal, *The Commercial Paper Market and the Securities Act*, 39 U. Chi. L.Rev. 362, 389 (1972).

[41] *See* 49 Stat. 707.

superfluous if, as the majority stated, Congress intended the term "notes" to mean only "notes issued to raise money over an extended period of time as part of a corporation's capital structure." And, while Congress enacted an exception for mortgage notes, Congress never has enacted an exception for commercial paper notes.[42]

More fundamental, however, is the complete lack of any evidence that Congress intended the majority's construction of the statutory language to apply. The terms "investment notes" and "notes issued to raise money over an extended period of time as part of a corporation's capital structure" appear nowhere on the face of the Glass-Steagall Act and nowhere in its legislative history.[43] They also bear little resemblance to the term Congress actually used to express its will—"notes." As a result, the majority was obligated to explain why Congress intended "that the letter of the statute is not to prevail." [44] This the majority failed to do.[45]

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[42] Where Congress has provided express exceptions, the courts, of course, will not imply or read other exceptions into the statute. *See, e.g., Andrus* v. *Glover Construction Co.*, 446 U.S. 608, 616-617 (1980); *SEC* v. *Ralston Purina Co.*, 346 U.S. 119 (1953); *Continental Casualty Co.* v. *United States*, 314 U.S. 527, 533 (1951).

[43] The majority's analysis does not even support its own conclusion that the Act's prohibition applies only to "capital-raising" notes. As noted above (*see* p. 7, *supra*), the majority limited its holding to commercial paper with certain characteristics. But, these characteristics have no relationship to whether the notes are capital-raising.

[44] *See, e.g., Rubin* v. *United States*, 449 U.S. 424, 430 (1981); *TVA* v. *Hill, supra*, 437 U.S. at 187 n. 33. *See also, Ford Motor Credit Co.* v. *Cenance*, 452 U.S. 155, 158 n.3 (1981).

[45] The majority argued that, because Section 16 permits banks to "discount and negotiate promissory notes," the Glass-Steagall Act does not forbid banks to underwrite all "notes" (J.A. 233). Section 16's authorization to "discount" and "negotiate" notes, however, does not empower banks to "underwrite" notes. *See, e.g., Weckler* v. *First National Bank*, 42 Md. 581, 592 (1875); *First National Bank* v. *The National Exchange Bank*, 92 U.S. 679, 681 (1876) (Section 16 does not authorize banks to "engag[e] in the ordinary business of buying and selling [notes] for profit"). In fact, the authorization in Section 16 to discount and negotiate promissory notes derives from Section 8 of the National Bank Act of 1864, 13 Stat. 101, and is merely the source of commercial banks' power to perform the traditional banking

(footnote continues)

The majority's failure to enforce the plain statutory language accordingly can be understood only as a disagreement with the Congressional policy it embodies. But, Congress enacted a broad and flat prohibition, and the courts are bound to enforce the prohibition according to its terms. As Judge Robb succinctly put it:

> The terms "stocks," "bonds," "debentures," and "notes" have broad meanings which encompass a multitude of different instruments. The term "other securities" further indicates the breadth of the Act's coverage; it catches any instruments which are not otherwise defined by the prior four terms. Taken as a group these five terms cover the spectrum of instruments which a corporation might seek to market. Relying "squarely on the language * * * of the Glass-Steagall Act," *Board of Governors of the Federal Reserve System* v. *Investment Company Institute,* 450 U.S. at 65, * * * commercial paper is a type of instrument with which the Act is concerned.

(J.A. 256-257; 693 F.2d at 155).

C. The Legislative History Surrounding the Glass-Steagall Act Demonstrates that Congress Intended the Words "Notes" and "Securities" to Encompass Commercial Paper

The legislative history surrounding the enactment of the Glass-Steagall Act confirms that Congress intended the words "notes" and "securities" to encompass commercial paper. In response to the stock market crash of 1929 and the ensuing

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(footnote continued)

function of *purchasing* commercial paper by means of "discount." *National Bank* v. *Johnson,* 104 U.S. 271, 277 (1881); *see First National Bank* v. *Hartford,* 273 U.S. 548, 599 (1927); *Steward* v. *Atlantic National Bank,* 27 F.2d 224, 228 (9th Cir. 1928).

The majority also argued that the term "notes" could not mean "notes" because the Glass-Steagall Act then would prohibit banks from having any connection with banker's acceptances, certificates of deposit, or loan participation notes (J.A. 235, n. 48; 693 F.2d at 144, n. 48). The Act, however, does not prohibit banks from having "any connection with" notes; it prohibits them from "engaging in the business" of "underwriting" notes. *See* 12 U.S.C. §§ 24 (Seventh), 378(a)(1).

Great Depression, Congress enacted several pieces of legislation to restore public confidence in the nation's financial markets—the Banking Act of 1933 (the Glass-Steagall Act), the Securities Act of 1933, the Securities Exchange Act of 1934, the Banking Act of 1935, and the Public Utility Holding Company Act of 1935. Throughout these statutes, Congress expressly reflected its awareness that, unless modified, the use of the terms "notes" and "securities" would encompass commercial paper. In each of those cases where Congress intended to exclude commercial paper from the coverage of the statute (or portions thereof), Congress took action to provide exceptions. It never did so under the Glass-Steagall Act.

The Securities Act of 1933, for example, enacted into law just twenty days *before* the Glass-Steagall Act, defines the term "security" to include "*any* note." 15 U.S.C. § 77b(1) (emphasis supplied). During the hearings on the Securities Act, Senator Glass expressed dissatisfaction with this definition because it plainly encompassed commercial paper. Accordingly, he proposed, with the support of the Board, an amendment to the definition of the term "security" which would have expressly excluded commercial paper from its scope.[46]

Congress refused to adopt the proposed amendment. Instead, it chose merely to exempt some forms of commercial paper from the *registration* requirements of the Act,[47] preserving the status of all commercial paper as "securities," and preserving the application of the Act's *antifraud* provisions to all commercial paper "securities."[48] When the same committees of the same Congress considered the legislation that would become the Glass-Steagall Act, however, no one, including Senator Glass and the Board, sought to amend the words "notes" or "securities" to exclude commercial paper

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[46] *See Hearings on H.R. 4314 before the House Comm. on Interstate & Foreign Commerce*, 73d Cong., 1st Sess. 180-181 (1933); *Hearings on S. 875 before the Senate Comm. on Banking & Currency*, 73d Cong., 1st Sess. 120 (1933).

[47] 15 U.S.C. § 77c(a)(3), 77e.

[48] *See* 15 U.S.C. §§ 77l(c), 77q(c); *see also*, *Hearings on S. 875 before the Senate Comm. on Banking & Currency*, 73d Cong., 1st Sess. 234 (1933)(remarks of Sen. Adams).

from the class of corporate instruments the Glass-Steagall Act forbids commercial banks to underwrite.

One year later, Congress enacted the Securities Exchange Act of 1934, in which it again defined the term "security" to include "any note." 15 U.S.C. § 78c(a)(10). Because Congress desired to exclude certain types of commercial paper from the definition of the term "security," Congress again recognized that an express exception was necessary to achieve this goal. It accordingly added a provision to the statute expressly excluding certain forms of commercial paper from the Act. 15 U.S.C. § 78c(a)(10).

One year later, Congress enacted the Public Utility Holding Company Act of 1935. The terms of the Act strictly prohibit registered holding companies from acquiring any "securities." 15 U.S.C. § 79b(a)(16). But, because Congress recognized that this language would preclude the purchase of commercial paper, Congress added another provision expressly permitting the acquisition of *"such commercial paper and other securities"* as permitted by the SEC. 15 U.S.C. § 79i(c)(3) (emphasis supplied). As the phrase "and *other* securities" demonstrates, Congress expressly understood commercial paper to be a "security." *See* H.R. Rep. No. 1318, 74th Cong., 1st Sess. 15 (1935).

When Congress enacted the Banking Act of 1935 one business day later, however, it took no such action. Instead, it reaffirmed that, in 1933, it had used the term "notes" in its ordinary and literal sense. Thus, Congress refused to amend the Glass-Steagall Act to permit banks to underwrite bonds, debentures and "notes," but it did amend the Act to remove "mortgage notes" from its coverage. Congress did not amend the statute, however, to exclude commercial paper notes from its reach.[49]

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[49] Indeed, in the Banking Act of 1935, Congress reaffirmed the breadth of the Glass-Steagall Act's flat prohibition by enacting amendments designed to clarify that its restrictions apply to *all* corporate "securities" and not just to corporate "investment securities." As originally enacted, Section 16 provided that the business of dealing in "investment securities" by banks was limited solely to executing buy and sell orders as an accommodation to existing bank customers, *see* 48 Stat. 184-185 (1933); the 1935 amendments replaced the phrase "investment securities" with the broader phrase "securities and stock."

(footnote continues)

This history of Congressional action plainly establishes that Congress intended and understood the words "notes" and "securities" to encompass commercial paper. *See, e.g., Erlenbaugh* v. *United States,* 409 U.S. 239, 243 (1972). *Accord, Roadway Express, Inc.* v. *Piper,* 447 U.S. 752, 760 (1980). The majority, however, dismissed this contemporaneous evidence of Congressional intent out of hand. According to the majority, because the securities laws and the Glass-Steagall Act were designed to serve different purposes, the securities laws are "of little * * * relevance" in construing the Glass-Steagall Act (J.A. 241; 693 F.2d at 147).

This statement completely ignores the interrelationship between the securities laws and the Glass-Steagall Act. The securities laws and the Glass-Steagall Act all are part of "the complete regulatory scheme which the Congress enacted to mitigate the problems that the country faced in the 1930's." *Investment Company Institute* v. *Camp,* 274 F. Supp. 624, 642 (D.D.C. 1967), *rev'd,* 420 F.2d 83 (D.C. Cir. 1969), *rev'd,* 401 U.S. 617 (1971). Simply put, the securities laws and the Glass-Steagall Act both are separate pieces of an integrated statutory framework broadly designed to protect the nation's depositors *and* investors.[50]

To bolster its contrary conclusion, the majority relied primarily upon certain selected statements from the legislative history of the Glass-Steagall Act. In these statements, certain legislators complained that, during the preceding decade, banks had been involved with long-term speculative securities (J.A. 236-237; 693 F.2d at 144-145). Based upon these fragments, the majority reasoned that, even though the language of Section 21 plainly covers *all* "stocks, bonds, debentures, notes, or other

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(footnote continued)

See 49 Stat. 684 (1935). Section 16, as originally enacted, also prohibited banks only from underwriting "securities," *see* 48 Stat. 184-185 (1933); the 1935 amendments replaced the word "securities" with the broader phrase "securities or stock." *See* 49 Stat. 684 (1935).

[50] *See* 77 Cong. Rec. 937 (1933) (remarks of President Roosevelt) (Securities Act constitutes "but one step in our broad purpose of protecting investors and depositors"); 77 Cong. Rec. 5896 (1933) (remarks of Sen. Luce) (Glass-Steagall Act's "purpose is, by an extensive revision of our banking laws, to furnish more protection to depositors and investors").

This Court has recognized that the securities laws are relevant in construing the Glass-Steagall Act. In *Camp,* for example, this Court relied exclusively upon the definition of the term "underwriter" found in the Investment Company Act of 1940 to construe the term "underwriting" in Sections 16 and 21 of Glass-Steagall. *See Camp, supra,* 401 U.S. at 622-623; *Board of Governors, supra,* 450 U.S. at 65-66.

securities," Congress intended the Act to apply only to long-term speculative stocks, bonds, debentures, notes, and other securities, and not to commercial paper.

This analysis does not withstand scrutiny. Although bank involvement with speculative securities was one concern of the Congress that enacted the Glass-Steagall Act, it was far from the only, or even the principal, concern. Rather, Congress was concerned primarily with the conflicts of interest and other subtle dangers that arise when commercial banks attempt to act in the dual capacity of commercial and investment banker.[51] As this Court has recognized, Congress believed that the "promotional incentives" of investment banking and the investment banker's "pecuniary stake" in the success of the offerings it underwrites are "destructive of prudent and disinterested commercial banking." *Camp, supra,* 401 U.S. at 634. And, as Congress itself has recognized, the promotional pressures and pecuniary stake of investment banking are present whenever a commercial bank underwrites any issue of "stocks, bonds, debentures, notes or other securities," including commercial paper, no matter how safe or sound the particular issue may be.[52]

The structure of the Glass-Steagall Act itself confirms that Congress was concerned with more than speculative securities.[53] And, Congress itself has provided exceptions from the Act's prohibitions for those notes and securities it considered

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[51] *Camp, supra,* 401 U.S. at 630. *Accord, Board of Governors, supra,* 450 U.S. at 66; Note, *A Conduct-Oriented Approach To The Glass-Steagall Act,* 91 Yale L. J. 102, 104-108 (1981) *("Yale Note").*

[52] *See, e.g.,* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley) (mere existence of bank securities operation "no matter how carefully and conservatively run is inconsistent with the best interests of the bank as a whole").

[53] For example, if Congress intended only "speculative" securities to be covered by the Act, it would have been unnecessary for Congress to enact an express exception in Section 16 to permit banks to purchase "investment securities" (that is, securities which are "not predominantly speculative," 12 C.F.R. § 1.3(b)). Congress also has specified in the statute at least fifteen separate U.S. governmental or general obligation securities (that is, very low risk securities) which banks are permitted to underwrite. 12 U.S.C. § 24 (Seventh). These exceptions also would have been unnecessary if Congress had not intended "low risk" securities to fall within the flat prohibition of the Act.

sufficiently low-risk for bank marketing. Where "Congress explicitly enumerates * * * exceptions to a general prohibition, additional exceptions are not to be implied" by the courts or administrative agencies. *Andrus* v. *Glover Construction Co., supra,* 446 U.S. at 616-617; *see also, SEC v. Ralston Purina Co. supra,* 346 U.S. at 126.[54] In short, the fragments of legislative history relied upon by the majority, "regardless of how liberally they are construed," simply do not amount to a clearly expressed legislative intent contrary to the plain language of the Glass-Steagall Act forbidding banks to underwrite all "notes or other securities." *See American Tobacco Co.* v. *Patterson, supra,* 456 U.S. at 75.

The majority also refused to enforce the plain statutory language because Congress did not expressly recite in the legislative history that the Glass-Steagall Act applies to all securities, regardless of "risk" and maturity, and thus applies to commercial paper.[55] Yet, this Court has instructed on numerous occasions that "[g]oing behind the plain language of a statute in search of a possibly contrary congressional intent is 'a step to be taken cautiously' even under the best of circumstances."[56] And, even on those occasions where this Court has taken that step, it has never insisted that Congress reaffirm the meaning of the plain statutory language in the legislative history as a condition of enforcing the statute.[57] The majority

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[54] As the district court stated, "[n]owhere in the Glass-Steagall Act is the Board authorized, despite the plain language of the statute, to permit banks to engage in a particular activity because it does not pose risks to consumers or investors" (J.A. 214-215; 519 F. Supp. at 614).

[55] There is no such express statement in the legislative history because, as the majority conceded (J.A. 236 n. 50; 693 F.2d at 145 n. 50), banks had not underwritten commercial paper in the decades preceding the enactment of the Glass-Steagall Act. Rather, the involvement of banks with commercial paper during this period was limited solely to purchasing commercial paper as part of their traditional commercial lending activities. *See, e.g.,* A. Greef, *The Commercial Paper House in the United States* 6-7, 15-18, 403-405 (1938).

[56] *American Tobacco Co.* v. *Patterson, supra,* 456 U.S. at 75 (quoting *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 26 (1977)).

[57] *See, e.g., Harrison* v. *PPG Industries, Inc.,* 446 U.S. 578, 592 (1980) ("[I]t would be a strange canon of statutory construction that would require

(footnote continues)

in effect treated as *law* language that Congress never passed as a bill and that the President never signed, *see, e.g., Schwegmann Brothers* v. *Calvert Distillers Corporation*, 341 U.S. 384, 395-397 (1951) (Jackson, J., concurring), in plain violation of the structure Article I establishes for federal lawmaking. *See INS* v. *Chadha, supra*, 103 S.Ct. at 2782-2788.

In sum, there is nothing in the language or legislative history of the Glass-Steagall Act to support the majority's view that Sections 16 and 21 do not apply to "notes or other securities," but only to "notes or other securities issued to raise money for an extended period of time as part of a corporation's capital structure." As a result, the majority below erred in grafting such a far-reaching distinction on to the Act:

> Had Congress intended so fundamental a distinction, it would have expressed that intent clearly in the statutory language or the legislative history. It did not do so, however, and it is not this Court's function "to sit as a super-legislature," *Griswold* v. *Connecticut*, 381 U.S. 479, 482, 14 L. Ed. 2d 510, 85 S.Ct. 1678 (1965), and create statutory distinctions where none were intended.

American Tobacco Co. v. *Patterson, supra*, 456 U.S. at 72 n. 6. *Accord, SEC* v. *Sloan, supra*, 436 U.S. at 111-117.

D. Even If A Functional Analysis Were Appropriate To Construe The Statute, A Functional Analysis Confirms That Commercial Paper Is A Note Or Other Security

As demonstrated above, the language of the Glass-Steagall Act plainly establishes that commercial paper constitutes "notes or other securities." The legislative history of the Act confirms what is obvious from its language. Yet, the majority nonethe-

(footnote continued)

Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of the statute. In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark").

less sanctioned the Board's decision to exclude commercial paper from the statute's reach.

It did so by approving the Board's decision to interpret the statutory language through a "functional analysis" and to excise any instrument which is " 'functionally similar to a traditional commercial banking operation' " (J.A. 242; 693 F.2d at 148) or which displays "the economic characteristics of a traditional loan" (J.A. 244; 693 F.2d at 149). Based upon such diverse "features" as the default rates and maturities of commercial paper, as well as the nature and sophistication of its purchasers, the majority held that the Board could exclude commercial paper from the Act's coverage because it constitutes the functional equivalent of a commercial bank loan (J.A. 244-246; 693 F.2d at 149).

As demonstrated below, the Board's "functional analysis" has no place in construing the statutory language. It is without legal foundation, is incapable of evenhanded application, and is inherently at odds with the flat prohibition of the Glass-Steagall Act. Even if use of a "functional analysis" is appropriate, however, a proper application of a "functional analysis" confirms that commercial paper falls within the flat prohibition of the Glass-Steagall Act.

There is nothing in the statute—either in its language or its legislative history—reflecting that Congress intended to authorize the Board to modify the Glass-Steagall Act by means of a functional analysis.[58] This omission is extremely significant, since Congress *has* enacted statutes authorizing administrative agencies, in appropriate circumstances, to modify the literal reach of the statute. Thus, Congress has provided in numerous statutes, including the federal securities laws [59] and *other* banking statutes not applicable here,[60] that the agency need not

[58] Ironically, Congress has rejected the use of a functional analysis even under the Bank Holding Company Act. Thus, in 1970, Congress refused the Board's request to replace the Bank Holding Company Act's "closely related to banking" test with a "functionally related to banking" test because it found that the functionally related standard constituted an unduly "liberal and expansive approach by the Federal Reserve Board in authorizing non-bank activities." H.R. Conf. Rep. No. 1747, 91st Cong., 2d Sess. 21 (1970), quoted in *Board of Governors, supra,* 450 U.S. at 73 n. 54.

[59] *See, e.g.,* 15 U.S.C. §§ 77b(1); 77ccc(1); 78c(a); 78u(h)(13); 79b(a); 80a-2; 80b-2.

[60] *See, e.g.,* 12 U.S.C. §§ 1730a(a); 1749bbb-2(a).

apply the statute according to its literal terms where "the context otherwise requires." [61] Congress, however, granted no such authority to the banking agencies in the Glass-Steagall Act.[62]

The Board's "functional analysis" also does not provide a principled means for interpreting the statute in a consistent and evenhanded manner. This follows from the Board's failure to identify the controlling principle of interpretation, a failure which pervades every "feature" comprising the Board's functional analysis (*See* J.A. 244-246; 693 F.2d at 149).[63] Indeed, the majority below conceded that, under the Board's functional analysis, there is "no foolproof formula" to determine whether any issue of commercial paper, much less any particular instrument of corporate finance, constitutes a "security" for purposes of the Act (J.A. 241; 693 F.2d at 147).

The reason for this silence is apparent. Once the language and legislative history of a statute are abandoned in favor of a collection of amorphous "features," the resulting interpretation itself can be nothing more than amorphous. Indeed, once the accepted tools of statutory construction are abandoned, all that remains is the sort of unbounded *ad hoc*, case-by-case adminis-

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[61] Congress has enacted at least 58 such statutory provisions. *See, e.g.*, 16 U.S.C. § 715; 19 U.S.C. § 1202; 20 U.S.C. § 1132 (b); 30 U.S.C. § 351; 33 U.S.C. § 1222; 39 U.S.C. § 102 (2); 42 U.S.C. § 4003.

[62] Even if the statute is to be interpreted by examining "features" of the instrument, it is noteworthy that the Board ignored the "features" used by the Office of the Comptroller of the Currency to distinguish loans from securities. *See Comptroller's Handbook for National Bank Examiners*, § 203.1 at 1 (1979) (loans result from direct negotiations between a buyer and lender; securities are acquired through a third-party). These "features" establish that commercial paper, indeed, is a "security."

[63] For example, the majority approved the Board's conclusion that commercial paper resembles a loan and not a security because it is "of very short maturity" (J.A. 245; 693 F.2d at 149). Neither the majority nor the Board, however, identified the maturity date dividing the two. Similarly, the majority held that commercial paper is the equivalent of a loan and not a security because it is marketed only to "sophisticated purchasers" (J.A. 245; 693 F.2d at 149). Yet, the majority and the Board omitted to specify the level of sophistication that distinguishes the two.

tration of the Glass-Steagall Act that Congress expressly rejected fifty years ago, and has rejected to this day.[64]

The Board's "functional analysis" also is an unsound barometer of Congressional intent because its application leads to a series of exceptions that engulf the entire statute.[65] Thus as Judge Robb (J.A. 252; 693 F.2d at 153) and the district court aptly summarized, the Board's functional analysis is fundamentally flawed because it

> would also sweep into its coverage almost all devices used by business to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.

(J.A. 217; 519 F. Supp. at 615).

In any event, proper application of a functional analysis establishes that commercial paper falls squarely within the Act's flat prohibition. The majority's analysis focused solely upon the purported characteristics of commercial paper, and rendered immaterial a bank's *role* in connection with the instrument.

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[64] The majority and the Board plainly envision *ad hoc* administration of the Act. For example, the Board explained in the district court that commercial paper could be a security if it is "marketed widely" (J.A. 192). In turn, the majority below warned that commercial paper could be a security if it were issued in "smaller denominations" or sold "to the general public" (J.A. 250; 693 F.2d at 151). But, because the Board and the majority never defined the terms "widely marketed," "smaller denominations," or "general public," the only manner in which their meaning can be determined is through a series of administrative and judicial proceedings designed to test the facts of each particular case against what little remains of the Act's flat prohibition. Of course, under the Board's functional analysis, this process must be repeated every time an issue of statutory coverage arises with respect to any corporate instrument.

[65] For example, the Board and the majority considered commercial paper the equivalent of a commercial bank loan because its purchasers purportedly function as lenders by providing funds to the issuer in return for its paper (J.A. 246; 693 F.2d at 150). This same process occurs, however, when an investor purchases any equity or debt instrument. *See, e.g., Yale Note, supra,* at 111 n. 75. The majority also held that commercial paper functions as a loan because it has maturities of nine months or less (J.A. 245; 693 F.2d at 149). But, bonds and debentures with maturities of nine months or less are commonplace today, just as they were in 1933. *See Supplemental Appendix.*

Thus, the majority dismissed the difference between a bank's *purchase* of commercial paper and a bank's *marketing* of commercial paper as the bank's simply being "on the other side of the transaction" (J.A. 246; 693 F.2d at 150). Yet, as Judge Robb recognized, this difference in the bank's role "is determinative under the Act," because "[t]he critical distinction between commercial banking and investment banking is the bank's role in the transaction" (J.A. 251; 693 F.2d at 152). *Accord, Yale Note, supra,* at 112-120.

For example, when a bank *discounts* or *purchases* commercial paper, as banks historically have done, the bank is performing its traditional lending function.[66] As Judge Robb explained, the transaction is really no different, for all practical purposes, than if the bank had extended a loan to the issuer in the amount of the discounted value of the commercial paper. In both cases, the bank provides funds to the issuer and derives its revenue from the interest (or discount) accruing to it. And, in both cases, the sole concern of the bank is to assess the loan as a risk (J.A. 251; 693 F.2d at 152).

In stark contrast, when a bank *markets* commercial paper, its role is completely different. The bank is not functioning as a lender, but is functioning as a *promoter*—the traditional role of an investment banker—distributing the issuer's commercial paper to third party investors.[67] When the bank acts in this role, its concern no longer is to assess the commercial paper as a lending risk, but to assess the commercial paper as a vehicle for earning fees or commissions (J.A. 251; 693 F.2d at 152). And, the bank's ability to recoup those fees is dependent solely upon

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[66] As one court has noted, the Glass-Steagall Act was intended "to compel commercial banks to return and confine themselves to their classic time-honored functions: acceptance of deposits of money subject to withdrawal by check or other means; *discount of commercial paper; and making loans.*" *Baker, Watts & Co.* v. *Saxon,* 261 F. Supp. 247, 249 (D.D.C. 1966), *aff'd sub nom., Port of New York Authority* v. *Baker, Watts & Co.,* 392 F.2d 497 (D.C. Cir. 1968) (emphasis supplied). *Accord,* 77 Cong. Rec. 3835 (1933) (remarks of Rep. Steagall).

[67] *See, e.g.,* 1 L. Loss, *Securities Regulation* 163, 172 (2d ed. 1961, Supp. 1969); W. Steiner, *Money and Banking* 322-334 (1933); *see also, United States* v. *Morgan,* 118 F. Supp. 621, 636-637 (S.D.N.Y. 1953); *Yale Note, supra,* at 104 n. 16.

its success in marketing the paper, and upon its success in competing with securities dealers.

Yet, it is precisely this role—competing as "promoters and sellers of securities" for a fee [68]—that Congress determined to be incompatible with the business of commercial banking, and, that prompted Congress to enact the Glass-Steagall Act. *Camp, supra,* 401 U.S. at 634-637.[69] As this Court observed:

> When a bank puts itself in competition with [securities dealers] the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking.[70]

The most telling indication that the bank's role here is an impermissible one has been provided by the Board itself. During the administrative proceedings below, the Board stated that "the Board is concerned about possible unsafe or unsound practices that would be involved in Bankers Trust's commercial paper activities and in similar activities by any other state member bank" (J.A. 146). In essence, the Board conceded that bank underwriting of commercial paper gives rise to the conflicts of interest, potential abuses, and other financial dangers that prompted Congress to enact the Glass-Steagall Act.

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[68] *See, e.g.,* 77 Cong. Rec. 3907 (1933) (remarks of Rep. Koppleman). *Accord, Hearings on S. Res. 71 before the Subcomm. of the Senate Comm. on Banking & Currency,* 71st Cong. 2d Sess. 1052 n. 24 (1931) (remarks of Sen. Glass) (Congress' goal was to prevent commercial banks from "merchandising" securities); *Yale Note, supra,* at 104-106.

[69] *See* (J.A. 251-253; 693 F.2d at 152-153). *Accord, Yale Note, supra,* at 118. (Banks which underwrite commercial paper are "participat[ing] in the commercial paper market to earn distribution commissions. To earn these commissions requires exactly the promotional, investment banking conduct that Glass-Steagall was designed to foreclose to commercial banks").

[70] *Camp, supra,* 401 U.S. at 637. Or, in the words of Senator Bulkley:

> If we want banking service to be strictly banking service, without the expectation of additional profits in selling something to customers, we must keep banks out of the investment security business.

75 Cong. Rec. 9912 (remarks of Sen. Bulkley), quoted in *Camp, supra,* 401 U.S. at 634.

Yet, the Board did not respond by strictly enforcing the Act's flat prohibition. Instead, it sought to alleviate its "concern" through regulation, promulgating guidelines the Board is not authorized to promulgate in an effort to minimize the hazards arising from the commercial paper underwriting activities of all state member banks (J.A. 186-189).

This response was manifestly improper. The Glass-Steagall Act is a prohibitory statute, not a regulatory statute. *See* pp. 11-16, *supra*. And, it is a prohibitory statute because Congress determined fifty years ago that the dangers that arise when commercial banks engage in the investment banking business are too subtle and pervasive to control through case-by-case regulation.[71] The duty of the majority below was to give effect to this legislative judgment, and not, by approving the Board's guidelines,[72] to subvert it.

It thus is of no consequence that allowing banks to underwrite commercial paper under administrative regulation may be more in tune with the Board's view of competition, "current business reality" and the "changing financial needs of our economy." Congress has preempted that kind of administrative judgment:

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[71] The Board confirmed the wisdom of this Congressional judgment when it conceded that its guidelines could only "minimize the danger[s]" that would flow from the commercial paper underwriting activities the Board had authorized (J.A. 185). The default of Penn Central on $82.5 million of commercial paper notes confirms the accuracy of the Board's concession. Only three weeks before the default, Penn Central's commercial paper had been marketed as "prime quality" and sold in large denominations to sophisticated purchasers, and thus would have been permissible for bank underwriting under the Board's guidelines (J.A. 253-256; 693 F.2d at 154-156).

[72] The majority upheld the Board's guidelines based solely upon a citation to this Court's decision in *Board of Governors* (J.A. 248 n. 96; 693 F.2d at 151, n. 96). But, this case, unlike the *Board of Governors* case, does not involve the *Bank Holding Company Act*. This case involves an activity that contravenes the *flat prohibition* of the *Glass-Steagall Act*. As a result, the controlling precedent here is not *Board of Governors*, but this Court's decision in *Camp* where this Court, reversing the Court of Appeals (*NASD* v. *SEC*, 420 F.2d 83, 88, 91, 95 (D.C. Cir. 1969)), held that administrative regulation cannot substitute for Congress' "prophylatic" statutory prohibition. *Camp, supra*, 401 U.S. at 639. *Accord, Agnew, supra*, 329 U.S. at 449 (1947) (The Act is "a preventive or prophylatic measure").

> From the perspective of competition, convenience, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards outlined above made it necessary to *prohibit* this activity to commercial banks.

Camp, supra, 401 U.S. at 636 (emphasis supplied).

CONCLUSION

The Glass-Steagall Act flatly prohibits banks from underwriting "notes or other securities." The language, legislative history, and purpose of the Act plainly establish that the prohibition encompasses commercial paper notes and securities. Because the majority opinion upholds the Board's contrary ruling, and sanctions the Board's decision to substitute a scheme of administrative regulation in the place of Congress' flat statutory prohibition, the judgment of the Court of Appeals should be reversed and the Board's ruling, as well as its guidelines authorizing banks to underwrite commercial paper, should be declared null and void.

Respectfully submitted,

/s/ HARVEY L. PITT

HARVEY L. PITT*
(*Counsel of Record)
HENRY A. HUBSCHMAN
DAVID M. MILES

FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
(A Partnership Including
Professional Corporations)
Suite 1000
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 342-3500

Counsel for Petitioner
A. G. Becker Incorporated

Of Counsel:

STEVEN M. LOONEY
General Counsel
A. G. BECKER INCORPORATED
55 Water Street
New York, New York 10041
(212) 747-6194

LAURENCE H. TRIBE
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4621

November 17, 1983

SUPPLEMENTAL APPENDIX

Exempt from Income Taxes

Federal, State, Municipal or Local

$20,000,000

Federal Intermediate Credit Bank

4%

Debentures

Maturities: 4, 6, 9, 12 months
Dated: March 15, 1930
Interest payable at maturity
Price: 100 and Interest.

Secured by loans and discounts representing advances made for production and marketing of crops and livestock under the Act of Congress approved March 4, 1923.

The twelve Federal Intermediate Credit Banks have an authorized capital of $5,000,000 each, a total of $60,000,000, subscribed by the Secretary of the Treasury, of which [illegible] has been paid. The remaining [illegible] being subject to call, on 30 days' notice by the banks, with the approval of the Federal Farm Loan Board.

The total assets of the banks on January 31, 1930 were approximately [illegible]. The total amount of debentures outstanding, including this issue will be approximately [illegible].

All the twelve Federal Intermediate Credit Banks are liable under conditions stated in the act, for the principal of and interest on the debentures of each bank.

Applications for the purchase of any of the above can be made through your dealer or any bank or through

Charles R. Dunn, *Fiscal Agent*

FEDERAL
Intermediate Credit Banks
31 Nassau St. New York City

WALL STREET JOURNAL

Interest exempt from all present Federal Income Taxation

$1,500,000

City of Buffalo, New York

0.98% Tax Anticipation Certificates of Indebtedness

Dated December 16, 1935 — Due June 16, 1936

Legal Investment, in our opinion, for Savings Banks and Trust Funds in New York State

Price to yield 0.70%

(accrued interest to be added)

HALSEY, STUART & CO. INC. — BANCAMERICA-BLAIR CORPORATION — LADENBURG, THALMANN & CO.

W. O. GAY & CO.

December 14, 1935

Exempt from all present Federal and New York State Income Taxation

$1,250,000

City of Utica, New York

1.60% Certificates of Indebtedness

Dated July 20, 1934 Due November 20, 1934

Legal Investment, in our opinion, for Savings Banks
and Trust Funds in New York State

Price to yield 1.00%

(accrued interest to be added)

HALSEY, STUART & CO.

INCORPORATED

NEW YORK, 35 Wall Street · CHICAGO, 201 South La Salle Street

AND OTHER PRINCIPAL CITIES

WALL STREET JOURNAL

New Issue

$900,000

National Steel Car Lines Equipment Trust

5% Equipment Trust Gold Certificates, Series "N"

To be unconditionally guaranteed by endorsement both as to principal and dividends by
PALACE LIVE POULTRY CAR COMPANY

To be issued under the Philadelphia Plan

GIRARD TRUST COMPANY, Philadelphia, Trustee.

To be dated April 15, 1931. To mature $50,000 semi-annually from April 15, 1932 to October 15, 1940, both inclusive. Both principal and dividend warrants are to be paid in gold coin of the United States without deduction of the normal Federal Income Tax not to exceed 2% per annum. *The Company will agree to reimburse the Pennsylvania State Tax not to exceed four mills annually upon application as set forth in the agreement.* At the option of the Palace Live Poultry Car Company, these certificates are to be redeemable at 101% of the face amount and accrued dividends on any dividend date upon thirty days' notice.

Mr. Erwin R. Brigham, President of the Palace Live Poultry Car Company, has written us a letter covering the issuance of these certificates, from which we summarize as follows:

Under a contract made with the National Steel Car Lines Company, Vendor, this issue of certificates is to be secured through deposit of title with the Trustee to the following standard railroad equipment:

515 steel underframe and steel superstructure poultry cars.

This equipment has a current sound value as certified to by the American Appraisal Company, of $1,375,000, *or more than 152% of the face value of the Certificates to be issued.*

Pending transfer of title to these cars, cash to the full face amount of the certificates will be deposited with the Trustee, to be withdrawn as cars are delivered.

The Palace Live Poultry Car Company is the largest and leading operator of railroad equipment for the transportation of live poultry in the United States.

We offer these certificates for subscription, subject to issuance as planned, [illegible] approval of counsel and to prior sale. It is expected that temporary or definitive certificates will be delivered on or about April 15, 1931.

Prices to yield from 4.00% to 5.20% according to maturity

Descriptive Circular on application.

FREEMAN & COMPANY

30 PINE STREET, NEW YORK

WALL STREET JOURNAL

EXEMPT FROM ALL FEDERAL INCOME TAXES
TAX EXEMPT IN NEW JERSEY

SHORT
MATURITY

$750,000

CITY OF ATLANTIC CITY, NEW JERSEY

2.90% TAX REVENUE BONDS

DUE MARCH 14, 1933

Principal and interest payable at maturity at the Central Hanover Bank & Trust Company, New York City. Bearer bonds in the denomination of $1,000.

Legal Investment for Savings Banks and Trust Funds in the States of New York and New Jersey

Assessed Valuation, 1931	$252,339,074
Net Debt	21,919,532

Population 1930 (U. S. Census) ... 65,748

These bonds are general obligations of the City of Atlantic City.

Legality approved by Messrs. Clay, Dillon & Vandewater of New York City

2.75% YIELD

RAPP & LOCKWOOD

60 BROAD STREET NEW YORK

TELEPHONE [illegible]

WALL STREET JOURNAL

WALL STREET JOURNAL

Interest exempt from all present Federal and New York State Income Taxation

$2,000,000

City of Syracuse, New York

0.87% Tax Anticipation Certificates

Dated February 6, 1935 Due October 15, 1935

Legal Investment, in our opinion, for Savings Banks and Trust Funds in New York State

Price to yield 0.65%

(accrued interest to be added)

HALSEY, STUART & CO. BANCAMERICA-BLAIR CORPORATION

WALL STREET JOURNAL

Exempt from All Income Taxes

$5,000,000

FEDERAL INTERMEDIATE CREDIT BANK

3% Debentures

[illegible] | [illegible]

Price on application

[illegible]

[illegible]

[illegible]

CHARLES R. DUNN, *Fiscal Agent*

FEDERAL INTERMEDIATE CREDIT BANKS

31 NASSAU STREET | NEW YORK CITY

WALL STREET JOURNAL

Ford Motor Credit Company

Medium-Term Notes

Due from 9 Months to 7 Years from Date of Issue

Price 100%

[illegible]	[illegible]
More than 9 months to 1 year	5[illegible] %
More than 1 year to 18 months	5[illegible] %
More than 18 months to 2 years	6[illegible] %
More than 2 years to 3 years	6[illegible] %
More than 3 years to 4 years	6[illegible] %
More than 4 years to 5 years	7 %
More than 5 years to 6 years	7 %
More than 6 years to 7 years	7 %

Goldman, Sachs & Co.

WALL STREET JOURNAL

[illegible]

[illegible]

GENERAL MOTORS ACCEPTANCE CORPORATION

Medium-Term Notes

Due From 9 Months To 5 Years From Date Of Issue

Interest payable each April 1 and October 1 and at maturity

Price: 100%

Minimum Denominations: More than 9 months to 5 years—$25,000
More than 3 years to 5 years—$10,000

Rates offered as of January 18, 1977 are:

Range of Note Maturities	Interest Rate Per Annum
More than 9 months to 1 year	[illegible]
More than 1 year to 18 months	[illegible]
More than 18 months to 2 years	6%
More than 2 years to 3 years	[illegible]
More than 3 years to 4 years	[illegible]
More than 4 years to 5 years	7%

Interest rates will be subject to change by the Company from time to time in relation to various ranges of maturities but no such change will affect any Notes issued prior to the effective date of change.

Copies of the Prospectus are obtainable from the following offices of General Motors Acceptance Corporation

NEW YORK
767 Fifth Avenue
New York, New York [illegible]
Phone: (212) [illegible]

ATLANTA
[illegible] Peachtree Road, N.W.
Atlanta, Georgia [illegible]
Phone: (404) [illegible]

BOSTON
[illegible] St. James Avenue
Boston, Massachusetts [illegible]
Phone: (617) [illegible]

CHICAGO
[illegible] South La Salle St., Suite [illegible]
Chicago, Illinois [illegible]
Phone: (312) [illegible]

CLEVELAND
[illegible] Road
Cleveland, Ohio [illegible]
Phone: (216) [illegible]

DALLAS
[illegible] Road
Dallas, Texas [illegible]
Phone: (214) [illegible]

DETROIT
[illegible] General Motors Bldg.
Detroit, Michigan [illegible]
Phone: (313) [illegible]

KANSAS CITY
[illegible]
Kansas City, Missouri [illegible]
Phone: (816) [illegible]

PHILADELPHIA
3 Girard Plaza
Philadelphia, Pennsylvania [illegible]
Phone: (215) [illegible]

PITTSBURGH
[illegible] Penn Plaza, Room [illegible]
Pittsburgh, Pennsylvania [illegible]
Phone: (412) [illegible]

SAN FRANCISCO
[illegible] California Street
San Francisco, California [illegible]
Phone: (415) [illegible]

[illegible]

WALL STREET JOURNAL

New Issue

$40,000,000

The City of Richmond Virginia

6.75%

REVENUE ANTICIPATION NOTES, 1982

(General Obligations)

Dated: January 15, 1982 Due: April 15, 1982

OFFERING PRICE 100%

IN THE OPINION OF BOND COUNSEL, INTEREST ON THE NOTES IS EXEMPT FROM FEDERAL INCOME TAXES UNDER EXISTING STATUTES AND COURT DECISIONS.

All these securities have been sold. This announcement appears as a matter of record only. [illegible]

CITIBANK, N.A.

January [illegible], 1982

WALL STREET JOURNAL

In the opinion of Bond Counsel, under existing statutes, regulations and court decisions, (1) the Series 1978 Bonds and the interest thereon are exempt from all taxation in the State of Michigan except inheritance taxes and taxes on gains realized from the sale, purchase or other disposition thereof, and (2) interest on the Series 1978 Bonds is exempt from Federal income tax.

NEW ISSUE

Standard & Poor's: (Prov.) A+
Moody's: A-1

$39,300,000

Kent Hospital Finance Authority

(Kent County, Michigan)

Hospital Facility First Mortgage Revenue Bonds

(Butterworth Hospital) Series 1978

Dated January 1, 1978 — Due: July 1 and January 1, as shown below

The Series 1978 Bonds are special obligations of the Kent Hospital Finance Authority (the "Authority") payable solely from revenues derived from the Project acquired by the Authority from Butterworth Hospital (the "Corporation") and leased to the Corporation for a net rental sufficient to pay principal of and interest on the Series 1978 Bonds and to maintain a Reserve Account in the Bond Fund. The Series 1978 Bonds do not constitute general obligations of the Authority within the meaning of any constitutional limitation or charter limitation and do not constitute nor give rise to a pecuniary liability of the Authority, except as described in the Official Statement, nor do the Series 1978 Bonds constitute an obligation of or a charge against the general credit or taxing powers of the City of Grand Rapids or Kent County. The Authority has no taxing power.

MATURITIES, AMOUNTS AND COUPON RATES

Maturity	Amount	Coupon Rate	Maturity	Amount	Coupon Rate	Maturity	Amount	Coupon Rate
7/1978	400,000	3.50%	1/1984	1,100,000	5.25%	1/1989	1,150,000	6.00%
1/1979	400,000	4.00	7/1984	1,100,000	5.25	7/1989	1,150,000	6.00
7/1979	400,000	4.25	1/1985	1,150,000	5.40	1/1990	1,050,000	6.10
1/1980	800,000	4.50	7/1985	1,150,000	5.40	7/1990	1,050,000	6.10
7/1980	800,000	4.50	1/1986	1,200,000	5.55	1/1991	1,050,000	6.15
1/1981	800,000	4.75	7/1986	1,200,000	5.55	7/1991	1,050,000	6.15
7/1981	800,000	4.75	1/1987	1,200,000	5.70	1/1992	1,050,000	8.20
1/1982	1,000,000	5.00	7/1987	1,200,000	5.70	7/1992	1,250,000	8.25
7/1982	1,200,000	5.00	1/1988	1,150,000	5.85	1/1993	1,260,000	8.30
1/1983	1,100,000	5.15	7/1988	1,150,000	5.85	7/1993	1,250,000	8.25
7/1983	1,100,000	5.15						

$8,800,000, 6.50% Term Bonds due January 1, 1998

All Bonds at Par plus Accrued Interest from January 1, 1978

The Series 1978 Bonds are offered when, as and if issued and received by the Underwriters, subject to the unqualified approval of legality by Miller, Canfield, Paddock and Stone, Detroit, Michigan, Bond Counsel, and certain other conditions.

The offering of these Bonds is made only by the Official Statement, copies of which may be obtained in any State from such of the undersigned as may lawfully offer these securities in such State.

Ziegler Securities, Inc. — B. C. Ziegler and Company

Bache Halsey Stuart Shields

Berg & Co. — E. F. Hutton & Company Inc. — Merrill Lynch, Pierce, Fenner & Smith

John Nuveen & Co. — Paine, Webber, Jackson & Curtis — Salomon Brothers

Weeden & Co. — Dean Witter Reynolds Inc.

Lehman Brothers Kuhn Loeb — Loeb Rhodes, Hornblower & Co.

Matthews & Wright, Inc. — The Ohio Company

Wm. C. Roney & Co. — L. F. Rothschild, Unterberg, Towbin

Herbert J. Sims & Co., Inc. — UMIC, Inc. — White, Weld & Co.

Cronin & Marcotte, Inc. — Dain, Kalman & Quail — A. G. Edwards & Sons, Inc.

Fahnestock & Co. — Manley, Bennett, McDonald & Co. — Oppenheimer & Co., Inc.

Piper, Jaffray & Hopwood — Prescott, Ball & Turben — Roose, Wade & Company

Shearson Hayden Stone Inc. — Van Kampen Sauerman Inc. — Wauterlek & Brown, Inc.

Buys-MacGregor, MacNaughton-Greenawalt & Co. — William G. Cass & Company

Channer Newman Securities Company — The Illinois Company — Edward D. Jones & Co.

Miller & Schroeder Municipals, Inc. — The Milwaukee Company

Peninsular Securities Company — Ryan, Sutherland & Co. Inc. — H. B. Shaine & Co., Inc.

Smith, Hague & Co. — Thomson McKinnon Securities Inc.

February 9, 1978

Under the provisions of the Acts of Congress now in force, the Notes and the interest thereon are, in the opinion of Bond Counsel, exempt from Federal, State, Commonwealth of Puerto Rico and local taxation.

NEW ISSUE — Standard & Poor's Corporation: AAA

$200,000,000

Commonwealth of Puerto Rico

Special Promissory Notes

Dated December 31, 1981 — Due June 30, as shown below

The Notes will be issued in the forms and payable at the places described in the Official Memorandum related thereto. The Notes will not be subject to redemption prior to maturity except under certain circumstances, as set forth in the Official Memorandum.

Principal of and interest on the Notes will be payable from revenues derived by the Commonwealth from certain previously uncollected taxes and, if necessary, from certain other moneys, and will be additionally secured by an irrevocable letter of credit issued by United States branches of

Bank of America National Trust and Savings Association,
Mellon Bank, N.A.,
National Westminster Bank Limited and
Société Générale.

Neither the credit of the Commonwealth nor that of any of its political subdivisions will be pledged for the payment of the Notes.

$200,000,000 Special Promissory Notes

Amount	Year	Coupon Rate	Price	Amount	Year	Coupon Rate	Price
$ 7,500,000	1982	8.75%	100%	$38,250,000	1985	10.50%	100%
26,500,000	1983	9.00	100	44,250,000	1986	11.00	100
32,000,000	1984	10.00	100	51,500,000	1987	11.50	100

(plus accrued interest from December 31, 1981)

All of these Notes having been underwritten and sold by the undersigned, this announcement appears as a matter of record only.

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

Bank of America NT & SA — **Mellon Bank, N.A.**

January 21, 1982

WALL STREET JOURNAL

New Issues

January 27, 1982

Federal Farm Credit Banks

The Thirteen Banks for Cooperatives
The Twelve Federal Intermediate Credit Banks
The Twelve Federal Land Banks

Consolidated Systemwide Bonds

14.30% $1,759,000,000
CUSIP NO. 313311 FJ 6
Dated February 1, 1982 Due August 2, 1982

14.50% $1,349,000,000
CUSIP NO. 313311 FN 7
Dated February 1, 1982 Due November 1, 1982

Interest on the above issues payable at maturity

Price 100%

The Bonds are the secured joint and several obligations of The Thirty-seven Federal Farm Credit Banks and are issued under the authority of the Farm Credit Act of 1971. The Bonds are not Government obligations and are not guaranteed by the Government.

BONDS ARE AVAILABLE
IN BOOK-ENTRY FORM ONLY.

Federal Farm Credit Banks
Fiscal Agency
90 William Street, New York, N.Y. 10038

Peter J. Carney, *Fiscal Agent*
Gerald F. Kierce, *Deputy Fiscal Agent*

FARM CREDIT BANKS

This announcement appears as a matter of record only

WALL STREET JOURNAL

This announcement is neither an offer to sell nor a solicitation of an offer to buy these Bonds. The offering of these Bonds is made only by the Official Statement which may be obtained from those dealers who may lawfully offer and sell the Bonds in this jurisdiction.

In the opinion of Bond Counsel, interest on the Bonds will be exempt under existing statutes, regulations, rulings and court decisions from all present Federal and Kentucky income taxes and the principal of the Bonds will be exempt from ad valorem taxation in Kentucky.

NEW ISSUE

Moody's: A (Con)
Standard & Poor's: A (Prov)

$67,000,000

Kentucky Development Finance Authority

Hospital Revenue Bonds, Series 1982

(Baptist Hospitals, Inc. Project)

Dated: January 15, 1982 — Due: September 1, as shown below

The Bonds, and the interest payable thereon, do not represent or constitute a debt of the Kentucky Development Finance Authority within the meaning of the provisions of the Constitution or statutes of the Commonwealth of Kentucky or a pledge of the faith and credit of the Authority or the Commonwealth of Kentucky. The Bonds, as to both principal and interest, are not an obligation of the Commonwealth of Kentucky, or of any political subdivision thereof. The Authority has no taxing power.

$13,410,000 Serial Bonds

Maturity	Amount	Interest Rate	Maturity	Amount	Interest Rate	Maturity	Amount	Interest Rate
1982	$760,000	8.75%	1986	$1,090,000	11.00%	1990	$1,665,000	12.75%
1983	810,000	9.50	1987	1,210,000	11.50	1991	1,910,000	13.00
1984	875,000	10.00	1988	1,345,000	12.00	1992	580,000	13.25
1985	975,000	10.50	1989	1,500,000	12.50	1993	670,000	13.50

$ 6,550,000 14.25% Term Bonds due September 1, 1999
$47,040,000 14.625% Term Bonds due September 1, 2011

ALL BONDS PRICED AT PAR

(Accrued interest from January 15, 1982, to be added)

Bonds of particular maturities may or may not be available from the undersigned or others at the above prices on and after the date of this announcement.

The Bonds are being offered by the Underwriters subject to prior sale and withdrawal of such offer without notice when, as and if issued by the Authority and accepted by the Underwriters, subject to the approval of their legality by Harper, Ferguson & Davis, Louisville, Kentucky, Bond Counsel, and the approval of certain legal matters by William H. Curl, Esq., Counsel for the Authority, ... Counsel for the Corporation and Gardner, Carton & Douglas, Chicago, Illinois, Counsel for the Underwriters.

Ziegler Securities, Inc.

J.J.B. Hilliard, W.L. Lyons, Inc.

B.C. Ziegler and Company — Bache Halsey Stuart Shields — Bear, Stearns & Co. — A.G. Becker

Blyth Eastman Paine Webber — Dillon, Read & Co. Inc. — Drexel Burnham Lambert

The First Boston Corporation — Goldman, Sachs & Co. — E.F. Hutton & Company Inc. — Kidder, Peabody & Co.

Lazard Frères & Co. — Lehman Brothers Kuhn Loeb — Merrill Lynch White Weld Capital Markets Group

John Nuveen & Co. — L.F. Rothschild, Unterberg, Towbin — Salomon Brothers

Shearson/American Express Inc. — Smith Barney, Harris Upham & Co. — Dean Witter Reynolds Inc.

Burr Brothers & Co., Inc. — Alex. Brown & Sons — Clark, Dodge & Co. — J.B. Hanauer & Co.

Rauscher Pierce & Co. — Henderson, Few & Co. — Interstate Securities Corporation — Matthews & Wright, Inc.

Arch W. Roberts & Co. — Thomson McKinnon Securities Inc. — Advest, Inc. — Bevill, Bresler & Schulman

Allen Bush Brokerage Co. — Butcher & Singer Inc. — Cumberland Securities Company, Inc.

Dryside Securities Corporation — James J. Duane & Co. Inc. — Fischer, Johnson, Allen & Burke Inc.

Hough, Orr & Jones, Inc. — Herzfeld & Stern — William K. Hough & Co.

The Lundy Corporation — Tucker, Anthony & ... — Mabon, Nugent & ... — Ebb, Tanner & Goldberg, Inc. — R.A. Moss

Park, Ryan Inc. — Wm. E. Pollock & Co., Inc. — Wheat, First Securities, Inc.

January 22, 1982

NEW ISSUES February 9, 1982

FNMA FEDERAL NATIONAL MORTGAGE ASSOCIATION

$2,000,000,000
15.50% Debentures

Dated February 10, 1982 Due August 10, 1982

Series SM-1982-P Cusip No. 313586 LQ 0

Non-Callable

Price 100%

$1,000,000,000
15.65% Debentures

Dated February 10, 1982 Due July 10, 1985

Series SM-1985-C Cusip No. 313586 LR 8

Non-Callable

Price 100%

The debentures are the obligations of the Federal National Mortgage Association, a corporation organized and existing under the laws of the United States, and are issued under the authority contained in Section 304(b) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1716 et seq.).

This offering is made by the Federal National Mortgage Association through its Vice President for Finance and Treasurer with the assistance of a nationwide Selling Group of recognized dealers in securities.

Debentures will be available in *Book-Entry* form only.
There will be no definitive securities offered.

John J. Meehan
Vice President for Finance and Treasurer

Allen C. Sell
Director of the Fiscal Office

100 Wall Street, New York, N.Y. 10005

This announcement appears as a matter of record only.

WALL STREET JOURNAL

No. 82-1766

In the Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS

REX E. LEE
Solicitor General

RICHARD K. WILLARD
Acting Assistant Attorney General

LOUIS F. CLAIBORNE
Deputy Solicitor General

BARBARA E. ETKIND
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
Attorney

Department of Justice
Washington, D.C. 20530
(202) 633-2217

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel

Board of Governors of the Federal Reserve System
Washington, D.C. 20551

QUESTION PRESENTED

Whether the court of appeals correctly upheld a ruling by the Board of Governors of the Federal Reserve System that commercial paper—short-term promissory notes issued by large, financially sound businesses in very large denominations to meet their current needs and sold to a small number of financially sophisticated purchasers that regularly purchase short-term credit instruments—is not a security for purposes of the Glass-Steagall Act.

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In the Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1766

SECURITIES INDUSTRY ASSOCIATION, ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS

OPINIONS BELOW

The opinion of the court of appeals (J.A. 220A-257A) is reported at 693 F.2d 136. The opinion of the district court (J.A. 194A-219A) is reported at 519 F. Supp. 602. The statement of the Board of Governors of the Federal Reserve System denying the petitions to initiate enforcement action (J.A. 122A-143A) is not reported. The Board's Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks (J.A. 183A-189A) is reported at 46 Fed. Reg. 29333.

JURISDICTION

The judgment of the court of appeals was entered on November 2, 1982. A petition for rehearing was denied on February 2, 1983 (J.A. 258A-261A). The petition for a writ of certiorari was filed on April 29, 1983, and was granted on October 3, 1983. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

1. Section 16 of the Banking Act of 1933, ch. 89, 48 Stat. 184 (the Glass-Steagall Act), as amended, now codified at 12 U.S.C. 24 (Seventh), provides in pertinent part:

> The business of dealing in securities and stock by the [national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [national bank] shall not underwrite any issue of securities or stock: *Provided*, That the [national bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. * * *

2. Section 21 of the Glass-Steagall Act, 48 Stat. 189, as amended, now codified at 12 U.S.C. 378(a)(1), provides in pertinent part:

> [I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits * * * : *Provided*, That the provisions of this paragraph shall not prohibit national banks or State banks * * * from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by [Section 16 of the Glass-Steagall Act] * * *.

STATEMENT

1. Commercial paper refers to unsecured, large-denomination promissory notes that are of prime quality, bear very short maturities, and are issued by large, well-known, and financially strong corporations to obtain

funds for seasonal or other current needs.[1] The commercial paper market is part of the Nation's wholesale money market in which a variety of low-risk, short-term, highly liquid obligations are sold.[2] Examples of other short-term, large-denomination instruments that are sold in the wholesale money market are bankers' acceptances and bank certificates of deposit.[3]

Only about 1,200 firms borrow money in the commercial paper market,[4] either by placing their paper directly or through dealers.[5] Commercial paper placed through dealers usually matures in 60 days or less; a large portion of such paper has maturities of less than 30 days. The minimum denomination of dealer-placed paper is very large, averaging $1 or $2 million per note and almost never less than $100,000.[6]

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[1] Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 527-528 (1977); Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 328 (1982); Lowenstein, *The Commercial Paper Market and the Federal Securities Laws*, 4 Corp. L. Rev. 128, 129 (1981); M. Stigum, *The Money Market* 626, 632 (rev. ed. 1983).

[2] Lowenstein, *supra*, at 129; Stigum, *supra*, at 1, 625.

[3] Stigum, *supra*, at 1, 35-36, 39-40. A certificate of deposit is a note evidencing a bank's obligation to pay a specified sum at a fixed maturity. G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 173-174 (8th ed. 1983). A bankers' acceptance is an order drawn on a bank to pay a specified sum on a specified date (usually several months in the future) that the drawee bank has accepted, *i.e.*, agreed to pay at maturity. Stigum, *supra*, at 39-40, 602.

[4] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 327.

[5] As of September 1983, more than one-half of the commercial paper outstanding was placed directly by issuers. 69 Fed. Res. Bull. A24 (Nov. 1983). This case, of course, involves only dealer-placed commercial paper.

[6] Lowenstein, *supra*, at 147; *The Commercial Paper Market*, *supra*, at 525, 528, 530; Stigum, *supra*, at 626, 631. Paper that is placed directly by the issuer may be available in smaller denominations. Hence, it sometimes is purchased by individuals. *The Commercial Paper Market*, *supra*, at 529; *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 334.

Because it is a wholesale market, commercial paper is not distributed or advertised for sale to the general public. Instead, commercial paper is purchased by large, financially sophisticated purchasers, predominantly institutions such as money market mutual funds, trust departments of banks and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations and nonfinancial corporations. Banks also hold a small amount of commercial paper for their own accounts.[7]

Although commercial paper is unsecured, the market has developed a number of mechanisms to ensure that the obligations are repaid at maturity. Borrowers in the market maintain lines of credit, usually in an amount equal to 100% of their outstanding paper, on which they may draw to repay the paper if they are otherwise unable to do so.[8] Commercial paper also is rated by five independent rating services; unrated or low-rated paper is not readily accepted in the market.[9] Since the default by Penn Central in 1970 on its outstanding commercial paper, which resulted in the widespread establishment of such mechanisms as backup lines of credit, there has not been a single default of substance in the commercial paper market.[10] Reflective of the low risk of paper purchased in the market today is the fact that rates currently paid on commercial paper exceed only slightly those paid on short-term United States government obligations.[11]

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[7] *The Commercial Paper Market Since the Mid-Seventies, supra,* at 327, 333-334; *The Commercial Paper Market, supra,* at 529.

[8] Stigum, *supra,* at 39, 332; *The Commercial Paper Market, supra,* at 530; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 328, 333; Goldman, Sachs am. br. 11.

[9] *The Commercial Paper Market, supra,* at 528-529; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 331-332; Stigum, *supra,* at 635-636. See also pages 40-41, *infra.*

[10] See note 90, *infra.*

[11] Stigum, *supra,* at 638; *The Commercial Paper Market, supra,* at 530.

In sum, commercial paper is a well defined, well recognized instrument, as is evidenced by its exemption from the registration requirements of the Securities Act of 1933, 15 U.S.C. 77c(a)(3),[12] and its exclusion from the definition of the term "security" in the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10).[13] Firms serving exclusively as dealers in commercial paper also are not subject to the broker/dealer registration requirements of the 1934 Act, 15 U.S.C. 78o(a)(1). The commercial paper market, like the markets for bankers' acceptances and third-party certificates of deposit, is thus largely self-regulating.[14]

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[12] Section 77c(a)(3) exempts from the registration requirements of the 1933 Act "[a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." See also SEC Securities Act Release No. 4412 (Sept. 20, 1961); 26 Fed. Reg. 9158 (1961) (commercial paper that is not registered under the 1933 Act must be of prime quality, not ordinarily purchased by the general public, and issued to facilitate well-recognized types of current operational business transactions).

[13] Section 78c(a)(10) excludes from the definition of "security" for purposes of the 1934 Act "any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

[14] The commercial paper at issue in this case is entirely different from the type of obligation that was involved in *John Nuveen & Co.* v. *Sanders*, 425 U.S. 929 (1976), vacating and remanding 524 F.2d 1064 (7th Cir. 1975). Although labelled "commercial paper," the notes involved in *Sanders* were "offered and sold to the general public" in small amounts (as low as $3,000) and were not of "prime quality." *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079 & n.14 (7th Cir.), cert. denied, 409 U.S. 1009 (1972). Moreover, the large majority of purchasers were individuals. *Id.* at 1080 n.18. By contrast, paper placed in the established market is not offered to the general public, sold in small denominations or purchased primarily by individuals. See, *e.g.*, *Zeller* v. *Bogue Electric Manufacturing Corp.*, 476 F.2d 795, 800 (2d Cir.), cert. denied, 414 U.S.

2. During 1978, Bankers Trust Company (Bankers Trust), a New York chartered member bank of the Federal Reserve System, began serving as the agent of several of its corporate customers in placing their commercial paper in the commercial paper market. J.A. 123A, 223A-224A. Petitioners, the Securities Industry Association (SIA), a securities industry trade association, and A.G. Becker, Inc. (Becker), a commercial paper dealer, informally expressed concern to the Board of Governors of the Federal Reserve System about Bankers Trust's commercial paper activities. SIA and Becker subsequently petitioned the Board, among other things, to issue a ruling to the effect that Bankers Trust's activities are unlawful. J.A. 122A.

On September 26, 1980, after considering information obtained through informal discussions with, and written submissions by, the interested parties, as well as through an on-site examination by the Board staff of Bankers Trust's commercial paper activities (J.A. 105A-106A),[15] the Board issued a statement in response to the petitions of SIA and Becker. J.A. 122A-143A. The statement explained the reasons for the Board's conclusion that the commercial paper placed by Bankers Trust is not a security for purposes of the Glass-Steagall Act and therefore is not subject to the Act's prohibitions against underwriting and dealing in securities.[16]

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908 (1973) (referring to the "general notion of 'commercial paper' reflected in [SEC Release 4412]" (see note 12, *supra*)); see also *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359 (7th Cir.), cert. denied, 423 U.S. 825 (1975).

[15] The staff's examination revealed that Bankers Trust's activities were confined to the recognized, wholesale commercial paper market. The bank was not offering commercial paper to the public but ordinarily placed the paper with institutions that purchase other short-term instruments sold by Bankers Trust. The paper placed by the bank had average minimum denominations of $1 million, matured in approximately 60 days and was purchased by no more than 15 institutions at a time. J.A. 105A-106A.

[16] In view of the Board's disposition of the "securities" issue, it did not reach the question whether Bankers Trust's method of

The Board first observed that Congress did not intend every instrument that could be characterized as a note or security to be subject to the Act's prohibitions on underwriting and dealing (J.A. 126A-135A). Based on the language, legislative history and administrative interpretation of the Act, as well as the underlying legislative purpose to separate commercial and investment banking, the Board found that Congress could not reasonably have viewed instruments with which banks routinely deal as a part of their commercial banking business as the type of "securities" covered by the prohibitions enacted to effect the intended separation. *Ibid.* Accordingly, the Board concluded (J.A. 135A) that "if a particular kind of financial instrument evidences a transaction that is more functionally similar to a traditional commercial banking operation than to an investment transaction, then fidelity to the purposes of the Act would dictate that the instrument should not be viewed as a security."

Applying this standard to the commercial paper placed by Bankers Trust, the Board concluded that these obligations represent a transaction closer to commercial lending than to the sale of an investment. The Board recognized that, by contrast to the commercial paper market as it existed at the time the Glass-Steagall Act was passed, here the paper was being purchased primarily by institutions other than banks. In the Board's view, however, this fact alone did not alter the commercial lending nature of the transaction. Like the traditional commercial loan from a bank, commercial paper is very short-term. Moreover, the paper is purchased in denominations larger than an average investor can afford ($1 million on the average) by a small number of financial institutions and others that, like banks, are sophisticated financially and regularly purchase other types of short-term obligations. The role of Bankers Trust in this case, the

placing commercial paper constituted "underwriting" or other activity prohibited by the Act with respect to securities (J.A. 140A). The courts below also did not reach this question and it is not at issue in this Court.

Board therefore found, is similar to that of the lead bank in a loan participation or syndication, a traditional function of commercial banks. J.A. 135A-136A.

The Board subsequently issued a policy statement setting forth guidelines designed to ensure that the placement of commercial paper by state member banks would be consistent with the principles of safe banking (the Guidelines) (J.A. 183A-189A). As the court of appeals explained (J.A. 226A n.17), "the guidelines in essence describe Bankers Trust's activities." They thus limit a bank's activities in this area to the recognized commercial paper market by providing that a bank may place only prime quality paper, in large denominations, and only with financially sophisticated customers, and may not advertise any commercial paper for sale to the general public. J.A. 187A.[17]

3. Petitioners sought judicial review of the Board's ruling concerning the applicability of the Glass-Steagall Act to the commercial paper placed by Bankers Trust. The district court rejected the Board's interpretation, finding instead that any obligation that may be characterized as a note is a security for purposes of the Act. J.A. 194A-219A.

The court of appeals reversed (J.A. 220A-257A). It noted at the outset (J.A. 226A) that the district court "gave insufficient weight to the expertise of the Federal Reserve Board—as the agency responsible for administering the nation's banking system—in interpreting the provisions of the Glass-Steagall Act." In the view of the appellate court (J.A. 227A-229A), deference was due to the Board's construction of the statute because of that body's broad authority in numerous areas of banking regulation, its expertise in banking matters, the necessity

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[17] The Guidelines also admonish banks to maintain a complete credit analysis of the corporation issuing the paper, to exercise due diligence in investigating the corporation's financial condition, to maintain adequate records of the bank's operations, not to place paper with fiduciary accounts, and to provide adequate and accurate information to the purchaser concerning the paper being placed (J.A. 187A-189A).

in this case of applying general, undefined terms—notes and securities—to particular facts, and the thorough nature of the investigation undertaken by the Board and the findings made by it as well as their consistency with previous rulings.

The court of appeals did not, however, "rest merely on the deference to the conclusions of the Federal Reserve Board" (J.A. 230A). Instead, recognizing that the courts are the final arbiters of the meaning of a statute, the court of appeals undertook an independent analysis of the application of the Glass-Steagall Act to the facts of this case. Based on its own examination of the language of Sections 16 and 21 of the Act, the relevant legislative history, and the fundamental purposes underlying the Act, the court of appeals found "essentially correct" (*ibid.*) the Board's conclusion that only notes with the characteristics of an investment are securities for purposes of the Act and that the commercial paper placed by Bankers Trust is not such an instrument.

The court observed first (J.A. 231A; footnote omitted) that "Congress'[s] principal concern in [enacting the Glass-Steagall Act] was to protect the solvency and integrity of the banks themselves." The court then turned to an examination of the statutory language, recognizing (J.A. 232A; footnote omitted) that if it "clearly evinces a congressional determination to prohibit the activities in which Bankers Trust has engaged [the] inquiry necessarily comes to an end." To the contrary, however, the court of appeals concluded that both the statutory language and the legislative history "strongly suggest that commercial paper should be viewed as a loan rather than as a 'security' for the purposes of the Act" (J.A. 241A; see also J.A. 235A, 236A). The court determined, for example, that Congress's use of the word "notes" in conjunction with other terms with more specific meanings in the investment banking industry ("stocks," "bonds," and "debentures") strongly implies that notes that lack the investment characteristics of such securities, like com-

mercial paper, were not intended to be covered by the Act (J.A. 232A-236A).[18]

In accordance with the approach taken by this Court in *Investment Company Institute* v. *Camp*, 401 U.S. 617, 635-638 (1971) (*ICI I*), the court of appeals then examined the purposes of the Act in order to determine whether this type of bank involvement with commercial paper would result in the hazards and abuses the Act was designed to eliminate (J.A. 241A-249A). Like the Board, the court of appeals concluded that the commercial paper placed by Bankers Trust has the characteristics of a short-term commercial loan. The court relied on the following factors: the default rate on commercial paper placed in the established market is extremely low, the maturities are short, and the paper is purchased by large institutions and others that have the resources independently to verify representations by and about the issuers. J.A. 244A-246A. While the commercial paper placed by Bankers Trust differs from traditional lending by commercial banks in that funds are provided by other institutions rather than by the bank itself, the court determined that the bank's marketing of commercial paper would not convert the transaction into the sale of an investment since the bank's role does not give rise to the risk of loss and conflicts of interest that the prohibition against bank involvement in the investment banking business was designed to eliminate (J.A. 246A-247A). Based on the absence of serious risk of loss and the ability of purchasers to "fend for themselves," the court of appeals concluded that the bank's marketing of commercial paper would not result in the funds of bank depositors being tied up in speculative investments or result either in the bank's

[18] The court of appeals also agreed with the Board that the definition of a security in the federal securities laws is not determinative of what constitutes a security for purposes of the Glass-Steagall Act since the laws were enacted for fundamentally different purposes. As the court of appeals explained (J.A. 239A-241A), the securities laws were enacted for the protection of investors, while the Glass-Steagall Act was intended to protect banks and their depositors.

abuse of its reputation for prudence or in its provision of unreliable financial advice (J.A. 247A-249A).[19]

Senior Circuit Judge Robb dissented (J.A. 250A-257A). Although he purportedly would have left the question of whether the bank was engaged in underwriting to the Board and the district court on remand (J.A. 257A), in fact his analysis depended almost entirely on the role of the bank (J.A. 251A): "[T]he difference between the bank's role as 'purchaser' in a commercial loan transaction and its role as 'seller' in a third-party commercial paper transaction * * * is determinative under the Act. * * * The critical distinction between commercial banking and investment banking is the bank's role in the transaction."

SUMMARY OF ARGUMENT

A.

Petitioners' argument, simply put, is that because Section 21 of the Glass-Steagall Act refers to "stocks, bonds, debentures, *notes*, and other securities" (emphasis added), the Act's prohibitions on the activities of banks must apply to every instrument that is denominated a "note." It is common ground that commercial paper consists of negotiable promissory notes. Hence, petitioners contend, it is within the reach of the Act.

The dispositive answer to this textual argument is quickly stated. Commercial paper cannot be a "note" or "security" within the prohibition of Sections 16 and 21 of the Act unless it also qualifies as an "investment security," as defined in Section 16. That is so because, on the one hand, the cited sections forbid a commercial bank *even to buy for its own account* any covered security, except only "investment securities," and, on the other

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[19] The court of appeals emphasized (J.A. 250A) that the rationale of its holding necessarily does not apply to other obligations with different characteristics, such as smaller denominations, or that are offered to the public. Such obligations, the court noted, even if referred to as "commercial paper," might be securities under the Act. See also note 14, *supra*.

hand, it is unassailably clear that commercial banks may purchase commercial paper for their own account, as they always have done without objection. Thus, petitioners are relegated to one of two alternative propositions: Either they must assert, against the understanding of everyone in the field, that commercial paper, in all circumstances, fits within the special category of "marketable obligations evidencing indebtedness" that are "commonly known as investment securities," or they must say that commercial paper, although not by nature an investment security, becomes so when a commercial bank performs an intermediary role in placing it. Whatever may be said in favor of the latter argument, it obviously does not turn on the "plain meaning" of the terms "notes" and "securities" in the Glass-Steagall Act.

The provision of the Glass-Steagall Act that is most relevant to this case is Section 16, since it is the section expressly directed to the activities of banks. Our construction of that provision is confirmed when we look at the text as enacted in 1933. Whatever ambiguities there may be in the original language of Section 16, its constant reiteration of the phrase "investment securities" makes it plain that Congress was focusing solely on dealings in instruments bearing the characteristics of an investment. Nor has that focus changed. The amendments effected by the Banking Act of 1935 were labelled "technical" and no one suggests that they substantively altered Section 16. Now, as before, the provision is not concerned with instruments that do not bear the characteristics of an investment.

Petitioners' exclusive reliance on Section 21 is misplaced, not only because Section 16 is the provision of the Act that is directed at the activities of banks, but also because the proviso to Section 21 makes clear that nothing permitted to commercial banks under Section 16 is prohibited to them by Section 21. But even if we look to Section 21, its terms confirm that the Act is concerned only with bank dealings in instruments bearing the characteristics of an investment. To be sure, the word

"note" could embrace any written obligation to pay money, but its context indicates otherwise. Since the term is accompanied in Section 21 by other terms denoting specific, well-recognized types of permanent or long-term securities, Congress also must have used the word "note" in Section 21 in its more specialized, investment sense.

B.

Our analysis is fully supported by the relevant legislative history. As the Court has noted (*Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 70 (1981) (*ICI II*)), the Glass-Steagall Act was designed to "separat[e] as completely as possible commercial from investment banking." The Act, however, "surely was not intended to require banks to abandon * * * accepted banking practice[s]." *Id.* at 63.

More specifically, the legislative history of the 1927 McFadden Act, which first contained the narrow definition of "investment securities" re-enacted in Glass-Steagall, makes clear beyond peradventure that commercial paper was not an "investment security" as narrowly defined in Section 16.

Furthermore, the history of the Glass-Steagall Act reveals a distinction in the minds of its draftsmen between commercial paper "notes" on the one hand and "securities" or "investment securities" on the other. Indeed, the draftsmen regarded the purchase of commercial paper by a bank as the equivalent of a commercial loan, a traditional banking function to which the Act was intended to encourage banks to return. This legislative history demonstrates beyond doubt that the sponsors of the Glass-Steagall Act were not targeting the purchase of commercial paper by covered banks.

C.

The commercial paper market has changed markedly since the enactment of the Glass-Steagall Act in 1933. Banks are no longer virtually the only purchasers of commercial paper; the vast bulk of the commercial paper out-

standing today is held by nonbank purchasers. Nevertheless, commercial paper held by large, financially sophisticated institutions other than banks continues to function as the equivalent of a commercial loan to the issuer of the paper. Accordingly, it is immaterial whether the bank, in placing the paper, is engaged in an activity that, if conducted with respect to a security, would be prohibited by the Act. In any event, the role played by the bank in placing the paper is consistent with the view that the paper represents a commercial lending transaction. Because the bank places commercial paper only with large, financially sophisticated purchasers that routinely purchase other short-term credit instruments, the bank in effect is simply arranging a commercial loan from the purchasers to the issuer. Moreover, this activity of the bank gives rise to none of the "hazards" against which the Glass-Steagall Act was directed.

D.

Contrary to petitioners' assertions, the Board is not attempting to "regulate" the underwriting by banks of instruments that are "securities" within the meaning of the Glass-Steagall Act. Rather, the Board's ruling represents a determination that the commercial paper involved here is not a "security" for purposes of the Act and for that reason is not subject to the legislation's prohibitions. Properly viewed as the construction of the statute by the agency charged with its administration, the Board's ruling is entitled to considerable deference.

ARGUMENT

SHORT-TERM, LARGE-DENOMINATION COMMERCIAL PAPER PLACED WITH LARGE, FINANCIALLY SOPHISTICATED PURCHASERS IN THE RECOGNIZED COMMERCIAL PAPER MARKET IS NOT A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT

The Glass-Steagall Act, originally enacted in 1933 and amended in 1935, prohibits commercial banks from engaging in certain dealings in "securities." Even if we assume that the placing of any debt instrument with a very restricted group of third-party purchasers would qualify as "underwriting" or some other covered activity (a question not decided below and not presented to this Court), the threshold inquiry is whether short-term, large-denomination commercial paper that is bought only by large, financially sophisticated purchasers in the recognized commercial paper market, constitutes a "security" within the meaning of the Act. If not, the case is at an end.

Petitioners' argument, as we understand it, is that the "plain language" of the statute covers every instrument that can be characterized as a "note" or "security," regardless of its investment or commercial nature. We answer that contention with our own textual analysis. But, more fundamentally, our submission is that the purposes of the Glass-Steagall Act, as summarized in this Court's decisions and reflected in the legislative history, make plain that commercial paper was never the subject of the legislation and is not brought within its ambit merely because a commercial bank performs an intermediary role in placing it with other purchasers.

A. The Language And Structure Of The Glass-Steagall Act Demonstrate That The Statute Covers Only Instruments Representing Investments, Not Notes Evidencing Commercial Transactions

All too seldom can a complex issue be decided merely by parsing the bare words of a statute. Nevertheless, obeying the Court's familiar injunction, we begin with

the statutory language. As we shall see, that approach does not yield the result urged by petitioners. On the contrary, focusing only on the text, we are immediately put on guard that the Glass-Steagall Act does not prohibit commercial banks from all dealings in "notes" and "securities" of every description. And, once we trace the operative language through the Statutes at Large, we are very quickly led to the conclusion that instruments bearing the characteristics of an investment alone are the target of the legislation.

1. The most obviously relevant provision of the Glass-Steagall Act is Section 16—the only provision that directly addresses the prohibited and permissible securities dealings of commercial banks.[20] The Section[21] first reaffirms the powers of national banks as including, among other things, "discounting and negotiating promissory notes * * * and other evidences of debts."[22] Then, Section 16 addresses "[t]he business of dealing in securities and stock by [national banks]." Generally, covered banks are prohibited from "purchasing and selling such securities * * * for [the bank's] own account" and from "underwrit[ing] any issue of securities." There follows a proviso permitting commercial banks (subject to regulation by the Comptroller of the Currency) to purchase for their own account limited amounts of "investment securities," defined as "marketable obligations evidencing indebtedness * * * commonly known as investment securities." Redundantly, a national bank is expressly forbid-

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[20] Although by its terms Section 16 applies only to national banks, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, provides that state member banks of the Federal Reserve System are subject to the same limitations and conditions that Section 16 imposes on national banks "with respect to the purchasing, selling, underwriting, and holding of investment securities and stock."

[21] For the Court's convenience, we reproduce in an Appendix, *infra*, 1a-4a, the text of 12 U.S.C. 24 (Seventh), as it stood immediately after its revision by Section 16 of the Glass-Steagall Act, together with the text of the Section as amended by the Banking Act of 1935.

[22] This authority has been part of the National Bank Act since 1864. See the Act of June 3, 1864, ch. 106, § 8, 13 Stat. 101.

den to buy "any shares of stock of any corporation" for its own account. And, finally, a further stipulation exempts certain governmental obligations from "[t]he limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities."

This is no model of drafting. Yet, some conclusions may be drawn from the face of the text, even if we confine ourselves to the method of English Judges and treat Section 16 as an orphan with no known family history.

We first notice that covered banks are permitted, subject to quantitative limitations, to purchase for their own account specially defined "investment securities." Presumably, this is a particular species belonging to the broader family of "securities and stock" which banks are otherwise forbidden from acquiring except for customers. The excluded species—which covered banks cannot buy for their own account—must be securities, including equity, that are more speculative and involve a greater risk of loss than the approved "investment securities."[23] We could, of course, stop here, having divided the entire universe of financial instruments into two categories: relatively "safe" debt obligations in which banks may invest, and more speculative securities that are barred to them. But this is immediately unsatisfactory.

The problem is that we have not accounted for high quality, low-risk obligations that are not "commonly known as investment securities" because of their very short maturities or their appeal to only a select market—such as commercial paper. We know that commercial banks have always purchased this kind of paper and there is no reason why they ought not be free to do so, given that they may buy some more fluctuating long-term "investment securities" for their own account. Yet, covered banks now *are* prohibited from acquiring these short-term obligations if they must be subsumed within the family

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[23] Indeed, exercising the authority expressly given him in Section 16, the Comptroller of the Currency has further defined "investment securities" as excluding investments that are "predominantly speculative in nature." 12 C.F.R. 1.3(b).

of "securities and stock" addressed in Section 16. The only rational explanation is that the Glass-Steagall Act does not reach such obligations at all—because the statute is only concerned to regulate bank dealings in instruments representing investments.

In sum, the universe of debt obligations is divided into *three*, not two parts: (1) speculative securities that (like stock) commercial banks cannot touch except as agents for their customers; (2) special "investment securities" that they may purchase for their own account but cannot otherwise deal in; and (3) other obligations (including, but not limited to, commercial loan notes) that commercial banks are free to buy and sell or place for others.[24] Since it is common ground that banks may purchase commercial paper, it cannot fall within the first category.[25] And yet, as we show in a moment, commercial paper does not qualify as an "investment security," as narrowly defined in Section 16. Hence, commercial paper must be in the last of our categories, unregulated by the Glass-Steagall Act.

2. Our reading of Section 16 as it now appears in the statute book is confirmed if we look at the original text

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[24] We put to one side the government securities mentioned in Section 16 that commercial banks may purchase without limit. For present purposes, it is irrelevant whether these are viewed as a subclass of category (2) "investment securities" or a distinct fourth category.

[25] Although the authority of national banks to continue to purchase commercial paper for their own accounts might be predicated on the pre-existing power, conferred by the National Bank Act of 1864, to "discount[ ] and negotiat[e] promissory notes" (12 U.S.C. 24 (Seventh)), that authorization does not extend to state-chartered member banks. Even if state law afforded state banks analogous "discount and negotiate" power, such authority would have been preempted by the Glass-Steagall Act's proscription on banks purchasing securities for their own accounts if commercial paper constituted a "security." Accordingly, the fact that state-chartered as well as national banks continued to buy commercial paper for their own accounts after enactment of Glass-Steagall demonstrates that such paper plainly is not a "security" other than an "investment security" within the meaning of the Act.

enacted in 1933, before its amendment by the Banking Act of 1935.

In the Glass-Steagall Act of 1933, the relevant portion of Section 16 was addressed exclusively to national bank involvement with what were termed "*investment* securities" (emphasis added). That term was repeated no less than six times in the 1933 Section. It was obviously carried forward from the McFadden Act of 1927, ch. 191, 44 Stat. 1224 *et seq.*, itself an amendment to the National Bank Act, which authorized covered banks to engage, in a limited way, in "the business of buying and selling investment securities." Now, in 1933, that authorization was cut back. But the focus remained the same: the connection between national banks and instruments bearing the characteristics of investment.

To be sure, "investment securities," as used in the original Glass-Steagall Act, was perhaps too narrow if the term was always to be understood in the restrictive sense of the definition provided in Section 16. And that presumably explains why the word "investment" was omitted when the expression was replaced by "securities and stock" in 1935. See Banking Act of 1935, ch. 614, § 308(a), 49 Stat. 709. Henceforth, the term "investment securities" was reserved as a definition of the restricted category of securities that national banks may purchase for their own account. There is, however, no basis for reading more in the 1935 amendments than an intent to tidy a careless text.

In light of the legislative history of these amendments, no such claim has or could be made.[26] There is, in any

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[26] Straying a moment from the statutory text, we note that the hearings and reports on the 1935 amendments to Section 16 and 21 of the Glass-Steagall Act indicate only one purpose: to make clear that although commercial banks may not purchase stock for their own account or deal in it, they may act as stock brokers for their customers. See H.R. Rep. 742, 74th Cong., 1st Sess. 18 (1935); *Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency*, 74th Cong., 1st Sess. 663 (1935); *Banking Act of 1935: Hearings on S. 1715 and H.R. 7617 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 74th Cong., 1st Sess. 114, 153 (1935). There is no hint of any larger

event, internal evidence against reading the amendments as working a change of law. They are expressly labelled "technical amendments," and, without going afield, we can discern the need for them by noting the imperfections of the 1933 text. We are, moreover, given another internal clue in the formulation of the new proviso added to Section 21. See First Proviso added by Section 303(a) of the Banking Act of 1935, 49 Stat. 707. There, Section 16 is described as granting commercial banks limited permission to deal in "*investment* securities" (emphasis added). This may be a partial lapse in view of the linguistic revisions now made to Section 16. But it is hardly credible that the old terminology would have been retained if those revisions had been understood to effect a major substantive change.[27]

The upshot is that the Glass-Steagall Act, before and after its amendment, focused solely on dealings in instruments bearing the characteristics of an investment, whether in the narrow sense of the specially defined "investment securities" or more broadly. And, as we demonstrate in a moment, commercial paper simply does not fit that mold.

3. Recognizing, apparently, that commercial paper is within neither the "investment security" nor the other "security" prong of Section 16, petitioners rely instead on Section 21, arguing that because commercial paper consists of promissory notes it is within that Section's ban on the issuance, underwriting, selling or distributing of "stocks, bonds, debentures, notes, or other securities." 12 U.S.C. 378(a)(1). The full answer, it would seem, is in the proviso to Section 21 added in 1935, which makes

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purpose, as petitioners apparently recognize. See, *e.g.*, H.R. Rep. 742, *supra*, at 2 ("amendments make no fundamental changes in the existing banking laws").

[27] Likewise, Section 5(c) of the Glass-Steagall Act, 12 U.S.C. 335, which makes state member banks of the Federal Reserve System subject to the same limitations and conditions with respect to "investment securities and stock" as are imposed on national banks by Section 16 (see note 20, *supra*), has never been amended to reflect the changes in terminology wrought by the 1935 Act.

clear that nothing permitted to commercial banks under Section 16 is prohibited to them by Section 21. That is what we would expect: After all, Section 16 is the provision of Glass-Steagall that is specifically addressed to banks and it would be peculiar if greater restrictions on their activities were to be found in a provision that was directed at non-banking institutions. Indeed, petitioners themselves concede that the two provisions are "co-extensive" (Becker Br. 24; see also SIA Br. 14; ICI am. br. 8).

But if, notwithstanding the proviso, we look to the terms of Section 21, no different conclusion emerges. Section 21's prohibitions apply to "stocks, bonds, debentures, notes, or *other securities*" (emphasis added). When this provision is read together with Section 16 (as petitioners acknowledge it should be (SIA Br. 14; see also Becker Br. 24-26)), it strongly suggests that only those instruments that are "securities" ("investment" or other) for purposes of Section 16 will also be covered by Section 21's prohibitions. In any event, when the term "notes" is properly read in the context of the provision as a whole, it is clear that the reference is only to notes representing investments.

The words "stocks," "bonds," and "debentures" all refer to specific, well recognized types of permanent or long-term securities. Stocks, of course, represent ownership interests in a corporation.[28] Bonds are secured debt instruments, issued under a trust indenture agreement, that are sold to the public generally in small denominations (usually $1,000) and that bear maturities of from five to 30 years or longer.[29] "Debentures" are debt instruments similar to bonds in all respects except that they are unsecured.[30] Public issues of stocks, bonds, and de-

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[28] 1 A. Dewing, *The Financial Policy of Corporations* 55 (5th ed. 1953).

[29] Dewing, *supra*, at 168, 171-174, 176-179.

[30] W. Husband & J. Dockeray, *Modern Corporation Finance* 170 (6th ed. 1966).

bentures typically are registered with the Securities and Exchange Commission.

The word "notes," however, is susceptible to more than one meaning. On the one hand, the term is used in the investment banking industry to refer to debt obligations that, like bonds and debentures, are distributed to the public in small denominations under an indenture agreement, but that bear shorter maturities than bonds or debentures—usually from one to five years.[31] On the other hand, the term also is used in a generic fashion to refer to any written obligation to pay money.[32] When employed in this latter sense, the word "notes" encompasses a broad universe of instruments that have no close relationship to investment banking: handwritten I.O.U.'s, Federal Reserve notes (currency), bank deposit receipts, loan notes for the purchase of consumer goods, or notes representing a loan to a business.

Where a word "capable of many meanings" is used in conjunction with words of more limited meaning, it is limited and qualified by the specific words surrounding it "in order to avoid the giving of unintended breadth to the Acts of Congress." *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961).[33] Hence, the fact that Congress included the word "notes" in a list of other terms, each of which refers to a specific type of *investment* instrument, makes clear that Congress used the term "notes" in Section 21 of the Act not to connote all instruments that can be characterized as notes, but only notes of an investment character. Indeed, if the broad, generic meaning of "notes" were intended, it would have been unnecessary for Congress to specify "bonds" or "debentures" in the stat-

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[31] Dewing, *supra*, at 178.

[32] G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 724 (8th ed. 1983).

[33] See also *Third National Bank* v. *IMPAC, Ltd.*, 432 U.S. 312, 322 (1977) (citing the "familiar principle of statutory construction that words grouped in a list should be given related meaning"); *Jarecki* v. *G.D. Searle & Co.*, 367 U.S. at 307 ("a word is known by the company it keeps").

ute, since "notes" would have encompassed all debt securities.[34]

By using the words "notes" and "securities" in Section 21 in conjunction with other terms that refer to specific types of long-term investments, Congress indicated on "the face of the statute" (*Jarecki* v. *G.D. Searle & Co.*, 367 U.S. at 307-308) that these words should be interpreted in accordance with their specialized, investment meanings. Contrary to petitioners' contentions, the Board's interpretation does not result in engrafting nonstatutory limitations into the Act; the limitations on "notes" and "securities" are inherent in the manner in which the words are arranged in the statute. The statutory text itself directs us to examine the particular instrument to determine whether it shares that characteristic of an investment that is the common feature of each of the other enumerated instruments. The construction urged by petitioners, which would bring every instrument that can be characterized as a note within the ambit of the Act's prohibition, wrenches isolated words both from the statutory context in which Congress used them and from the underlying congressional purpose to separate investment banking from commercial banking (see pages 24-25, *infra*).[35]

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[34] For the same reasons, the term "other securities" also was not meant to refer to all notes. SIA's suggestion (Br. 12) that the juxtaposition of the words "notes" and "other securities" in Section 21 indicates that commercial paper, because it consists of promissory notes, must also be a "security" rests on petitioners' erroneous assumption that the term "notes" in Section 21 encompasses every instrument that may be denominated a note regardless of its commercial or investment nature.

[35] Particularly with respect to Glass-Steagall, this Court has recognized that words in the Act gather meaning from other words in the statute as well as from the underlying legislative purpose. See *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 447-449 (1947) (meaning of the phrase "engaged primarily" in Section 32 of the Act, 12 U.S.C. 78, determined by reference to the meaning of the phrase "engaged principally" in Section 20 of the Act, 12 U.S.C. 377, as well as to "the evil at which the section was aimed"). See also *Philbrook* v.

Moreover, petitioners' overbroad construction of the Act would bar many other commonly accepted banking functions. Since enactment of the Glass-Steagall Act banks have continued to engage in the marketing of notes not having the characteristics of an investment. For example, banks in effect sell note obligations to other lenders in arranging loan participations and buy and sell as dealers certificates of deposit and bankers' acceptances issued or accepted by other financial institutions. If petitioners were correct in arguing that every note is a "security" for purposes of the Glass-Steagall Act, these activities also would be prohibited by the Act.

B. The Legislative History Demonstrates That When Commercial Paper Is Purchased By A Bank For Its Own Account It Is Not A "Security" For Purposes Of The Glass-Steagall Act

The textual exegesis we have just undertaken, if not dispositive, carries us a long way to the conclusion that bank dealings in commercial paper were never intended to be inhibited by the Glass-Steagall Act, as originally enacted in 1933 or as amended in 1935. But any lingering doubts are put to rest when we leave the text and notice the legislative history of the relevant sections.

1. The central purpose of the Glass-Steagall Act has long since been identified by the Court itself and we need not retrace that ground in more than a few words. The statute was passed in reaction to the recent financial disaster that had included the failure of many banks and

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Glodgett, 421 U.S. 707, 713 (1975), quoting *United States* v. *Heirs of Boisdore*, 49 U.S. (8 How.) 113, 122 (1849).

The construction adopted by the Board and the court of appeals, moreover, is not inconsistent with the views expressed by this Court in *ICI I*, 401 U.S. at 635. In *ICI I*, it was unnecessary for the Court to reach the question of the extent to which debt obligations are covered by the Act, since that case involved equity interests in "the business of buying, holding, and selling stocks for investment." *Ibid.* Furthermore, the Court's dictum (*ibid.*) to the effect that the word "securities," as used in the Act, is broad enough to include "securities representing debt" does not suggest that *all* debt instruments are securities within the meaning of the Act.

the ruin of their depositors. Congress believed that commercial banks had significantly contributed to this result by their securities dealings, especially "perilous underwriting operations" and "stock speculation," and, accordingly, was determined to "separate[] as completely as possible commercial from investment banking." *ICI II*, 450 U.S. at 61-62, 70.

The particular concerns that animated Congress in divorcing commercial banks from the investment securities business have been fully catalogued. *ICI II*, 450 U.S. at 66-67; *ICI I*, 401 U.S. at 630-633. The most obvious threat to bank solvency was that, through misjudgment or misfortune, a bank might be forced to commit its own assets to hold illiquid and unmarketable securities. The "more subtle" dangers included the possibility that if investments sold by the bank proved unsuccessful, the bank, fearing loss of public confidence and good will, might make unsound loans to shore up its own securities operation or the businesses whose securities the bank was selling. There was also concern that banks would use their credit facilities to support speculative investment in securities, rather than for the service of "agriculture and commerce and industry." *ICI I*, 401 U.S. at 632 n.29. Finally, Congress feared that involvement in the investment banking business would prejudice a commercial bank's ability to provide reliable investment advice or might tempt it to unload securities it was unable to sell in accounts the bank managed as trustee.

In sum, the focus of the Glass-Steagall Act was on the perils of permitting commercial banks to return to the investment securities business. This alone strongly suggests that Congress was not addressing transactions in commercial paper, which were never viewed as the source of the problem. But we need not guess about it. There is ample indication in the legislative history that involvement in commercial paper was deemed a *proper* part of the commercial banking business.

2. Bank involvement in the commercial paper market can be traced back to the first banks organized in this country. A. Greef, *The Commercial Paper House in the*

United States 6-7, 15-18 (1938). Before the banking system developed extensive branching systems, the transfer of surplus, loanable funds from banks in one geographic locale to banks in other areas was difficult. Thus, borrowers whose local bank had no lendable funds at a certain time would place their loan notes, often through middlemen, with banks in capital surplus areas.[36]

Although banks purchased such obligations in the open market, through middlemen or directly, commercial paper held by a bank for its own account traditionally was treated for bank regulatory purposes as the making of a commercial loan by the bank, not as the purchase of an investment. Throughout this period and continuing to the present time commercial paper purchased by banks has been reported in the bank's public report of condition as a commercial loan, not as the purchase of a security. Greef, *supra*, at 173; J.A. 130A.

In 1927, Congress amended the National Bank Act of 1864 by enacting the McFadden Act, which recognized the legality of the then existing practice of national banks of dealing in and underwriting corporate bonds.[37] The Act provided that the business of buying and selling investment securities by a national bank "shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation, in the form of bonds, notes and/or debentures, commonly known as investment securities" subject to certain limitations based on the bank's capital.[38] The legislation's sponsor made crystal clear that the term "investment securities" as

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[36] There is some evidence that banks also served as dealers in commercial paper well before their entrance into the investment banking business in the 1920s. Before 1840, banks in various parts of the country were buying and selling commercial paper notes, either directly or through brokers. Greef, *supra*, at 15-18. "During the later years of [1861 to 1914] * * * some few banks even acted as regular dealers in commercial paper." *Id.* at 63.

[37] McFadden Act of 1927, ch. 191, § 2, 44 Stat. 1226-1227; see H.R. Rep. 83, 69th Cong., 1st Sess. 3-4 (1926).

[38] § 2(b), 44 Stat. 1226.

used in the Act did not include commercial paper, which was subject to the separate limitations on the amount of a bank's commercial loans.[39]

As discussed more fully above (pages 15-20, *supra*), when Congress again amended the National Bank Act six years later by passing the Glass-Steagall Act, it restricted dramatically the authority of national banks to deal in bonds and debentures. However, banks continued to be permitted to purchase certain "investment securities" for their own accounts *and this definition was not changed* by the Glass-Steagall Act or by the 1935 amendments.[40] Accordingly, commercial paper is no more an "investment security" within the proviso to Section 16 today than it was in 1927 or 1933. Because commercial paper plainly is not a "security" other than an "invest-

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[39] The following colloquy between Representatives McFadden and Wainwright is reported at 67 Cong. Rec. 3232 (1926) (emphasis added):

> MR. WAINWRIGHT. * * * I would like to ask the chairman of the committee about this limitation, which seems to be new, of 25 per cent of capital and surplus to be invested in any one security. How does it affect the limitation of 10 per cent provided in section 5200 of the Revised Statutes of the amount of any loan to any one interest or any one maker?
>
> MR. McFADDEN. This is an investment section and attempts to legalize that which the banks are doing now without authority of law. It does put a limitation on the amount of money they can use for investment purposes, such as underwritings, and we felt that there should be this limitation. I do not think it has any application to the question the gentleman raises provided for in section 5200 of the Revised Statutes.
>
> MR. WAINWRIGHT. *Let me ask the gentleman whether commercial paper, as generally understood and accepted, is regarded as investment security.*
>
> MR. McFADDEN. *No; it is not. Commercial paper comes under the limitation of section 5200 in the Revised Statutes. I never have known of commercial paper being construed as investment securities.*

Section 5200, now codified at 12 U.S.C. 84, continues to subject a bank's purchase of commercial paper for its own account to its lending limits.

[40] Compare 44 Stat. 1226 with 48 Stat. 185 and 49 Stat. 709.

ment security" (see pages 17-18, *supra*), it follows that commercial paper, at least when it is purchased by a bank, is not a "security" for purposes of the Act.

In addition, the legislative history of the Glass-Steagall Act itself recognizes the distinction between commercial paper "notes" on the one hand and "securities" or "investment securities" on the other. Indeed, the draftsmen of the Glass-Steagall Act regarded the purchase of commercial paper by a bank as the equivalent of a commercial loan, a traditional banking function to which the Act was intended to encourage banks to return. For example, the Senate Report decried "a loose banking policy which had turned from the making of loans on commercial paper to the making of loans on security." [41] In a similar vein, Senator Walcott, a manager of the bill that became the Act, stated:

> [F]rom 1924 or 1925 to 1929 * * * a complete change in our banking system [occurred] in the respect that business enterprises all over the United States began to finance their requirements by the sale of their own *securities* rather than by borrowing at the commercial banks upon their *commercial paper*—that is, upon their *notes.* * * *
>
> The commercial banking business in consequence of this extraordinary volume of security business declined. The banks had to change to a large extent their method of handling business. There was no longer the great demand for borrowing on commercial paper.[42]

Senator Glass, the chief draftsman of the Act,[43] also contrasted commercial paper with investment securities:

> In their open-market operations [the Federal Reserve Banks] have never bought a dollar of commercial

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[41] S. Rep. 77, 73d Cong., 1st Sess. 4 (1933).

[42] 75 Cong. Rec. 9904 (1932) (emphasis added).

[43] 75 Cong. Rec. 10072 (1932) (remarks of Sen. Glass).

paper. * * * They have bought investment securities.[44]

In sum, the criticism was that commercial banks had abandoned commercial paper in favor of investment in "securities." And what the Act was designed to end was bank dealings in *long-term* obligations. Thus, the Senate Report on the proposed legislation described as "a very fruitful cause of bank failures * * * the fact that the funds of various institutions have been so extensively 'tied up' in *long-term* investments." [45] Similarly, in his lengthy explication of the securities prohibitions of the Act, Senator Bulkley defined the affiliates targeted by the Act as corporations "operating in the *long-term* capital market in competition with the investment houses." [46] He also identified investment banking as "the mechanism for the supply of *long-term* funds to industry and to Government borrowers" [47] and spoke of the evils and hazards that result when a securities affiliate "hold[s] *long-term* securities" of a kind which the bank is not permitted to hold.[48] He further decried banks venturing forth into the "*long-term* capital market" [49] and encouraging borrowers seek-

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[44] 75 Cong. Rec. 9885 (1932).

Numerous other statements made during the hearings and floor debate on the legislation indicate an understanding that commercial paper is not a "security." *E.g.*, *Operation of the National and Federal Reserve Banking Systems: Hearings on S. 4115 Before the Senate Comm. on Banking and Currency*, 72d Cong., 1st Sess., Pt. I, 146 (1932) (remarks of Sen. Glass) (banking system has favored bonds and securities rather than commercial paper); *id.* at 66-67 (remarks of President of American Bankers Association) (distinction between credit on notes and accommodation on marketable securities); *Operation of the National and Federal Reserve Banking Systems: Hearings Pursuant to S. Res. 71 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 71st Cong., 3d Sess., App., Pt. VII, 1006-1019 (1931).

[45] S. Rep. 77, *supra*, at 8 (emphasis added).

[46] 75 Cong. Rec. 9909 (1932) (emphasis added).

[47] 75 Cong. Rec. 9909 (1932) (emphasis added).

[48] 75 Cong. Rec. 9909 (1932) (emphasis added).

[49] 75 Cong. Rec. 9910 (1932) (emphasis added).

ing to raise "*long-term* funds" to issue securities to be sold to the depositors of the bank.[50] By contrast, the legislative history is devoid of any congressional concern about bank involvement with short-term notes in general or with commercial paper in particular.

3. It is telling that petitioners' description (SIA Br. 17-21; Becker Br. 29-35) of the legislative history largely ignores the Glass-Steagall Act itself and relies instead on the history of other legislation, most of which was enacted by subsequent Congresses.[51]

Petitioners' reliance on various provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935, suffers from the same infirmity: all of these laws were enacted for reasons far different from the considerations that underlay the enactment of the Glass-Steagall Act.[52] As noted above, the Glass-Steagall Act was designed to protect *banks and their depositors* from insolvencies "partially attributable to the connection between commercial banking and investment banking." *ICI II*, 450 U.S. at 61. By contrast, the "primary purpose" of the securities legislation of 1933 and 1934 was to eliminate abuses from "the capital market of the enterprise system" and "to prevent fraud and to protect the interests of *investors*." *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975) (emphasis added); see also *Marine Bank* v. *Weaver*, 455 U.S. 551, 555 (1982) (the 1934 Act "was adopted to restore *in-*

[50] 75 Cong. Rec. 9912 (1932) (emphasis added).

[51] "[T]he views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one." *Consumer Product Safety Commission* v. *GTE Sylvania*, 447 U.S. 102, 117 (1980), quoting *United States* v. *Price*, 361 U.S. 304, 313 (1960).

[52] The fact that Congress declined to include in the Banking Act of 1935 a proposal to permit banks to underwrite and sell "bonds, debentures and 'notes'" under regulations prescribed by the Comptroller of the Currency (see Becker Br. 31; S. Rep. 1007, 74th Cong., 1st Sess. 16 (1935)) is entitled to no probative weight since there is no evidence that the proposed amendment was intended to apply to short-term notes like commercial paper.

vestors' confidence in the financial markets") (emphasis added).[53] In short, the Glass-Steagall Act and the securities laws were intended to serve widely divergent aims;[54] the scope of what constitutes a "security" for each therefore need not be the same in order to accomplish the congressional objectives. Even where they are enacted by the same Congress as part of a comprehensive legislative effort, separate statutes that "play different roles in achieving * * * broad, common goals" are not construed similarly or in pari materia. *Erlenbaugh* v. *United States*, 409 U.S. 239, 245 (1972). Accordingly, the legislative history on which petitioners rely is not determinative or even reliable evidence in construing the Glass-Steagall Act.[55]

Reference to the securities laws definitions for purposes of construing the word "security" in the Glass-Steagall Act is inappropriate for another reason as well. The 1933 Act, the 1934 Act and the Public Utility Holding Company Act of 1935 all define the term "security" as meaning, unless the context otherwise requires, "*any* note

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[53] The Public Utility Holding Company Act of 1935, 15 U.S.C. 79 *et seq.*, was designed to protect investors, consumers, and the general public from the false or misleading solicitation for securities of public utilities and from the adverse economic effects resulting from their complex and inefficient organizational structure. See 15 U.S.C. 79a(b).

[54] As Senator Bulkley explained (75 Cong. Rec. 9913-9914 (1932)):

> [T]he purpose of [the Glass-Steagall Act] does not extend to safeguarding purchasers of securities as such. The purpose of this bill is to improve the operation of the Federal reserve system and the banks which are members of it. The object of the inhibitions which I am discussing here is not primarily to protect the investing public, although that is a worthy purpose, but our field is to protect the operations of the banking system itself, and to protect the depositors and customers of the banks so that they shall have the service from national and State member banks which they are entitled to expect.

[55] In construing the meaning of the word "security" as used in Sections 16 and 21 in *ICI I*, this Court made no reference to the securities laws definitions.

* * *." 15 U.S.C. 77b(1), 78c(a)(10), 79b(a)(16). On its face, such language is more encompassing than the word "notes" as it is used in Section 21, *i.e.*, in a list of specific, long-term debt securities.

Finally, it is not even clear that the commercial paper involved here would constitute a security within the meaning of the securities laws provisions on which petitioners rely. Following this Court's lead,[56] the lower courts now uniformly look to the economic realities underlying the particular transaction in order to determine whether an instrument denominated as a note is a "security" within the meaning of the securities acts. Indeed, several courts have employed precisely the investment/commercial distinction that was applied by the Board and court below; on that basis, they have found long-term notes of a commercial nature not "securities" within the meaning of the securities laws and short-term notes of an investment nature covered by those laws, notwithstanding the express exclusion from the 1934 Act and the registration requirements of the 1933 Act for short-term notes only (see notes 12 & 13, *supra*).[57]

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[56] See, *e.g.*, *Marine Bank* v. *Weaver*, *supra*; *United Housing Foundation, Inc.* v. *Forman*, *supra*.

[57] See *American Bank & Trust Co.* v. *Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *Williamson* v. *Tucker*, 645 F.2d 404, 426-429 (5th Cir. 1981); *National Bank of Commerce* v. *All American Assurance Co.*, 583 F.2d 1295, 1300-1302 (5th Cir. 1978); *Emisco Industries, Inc.* v. *Pro's, Inc.*, 543 F.2d 38, 40-41 (7th Cir. 1976); *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359-1363 (7th Cir.), cert. denied, 423 U.S. 825 (1975); *Zabriskie* v. *Lewis*, 507 F.2d 546, 550-552 (10th Cir. 1974); *McClure* v. *First National Bank*, 497 F.2d 490, 492-495 (5th Cir. 1974), cert. denied, 420 U.S. 930 (1975); *Bellah* v. *First National Bank*, 495 F.2d 1109, 1111-1114 (5th Cir. 1974); *Lino* v. *City Investing Co.*, 487 F.2d 689, 694-696 (3d Cir. 1973); *Zeller* v. *Bogue Electric Manufacturing Corp.*, 476 F.2d 795, 799-800 (2d Cir.), cert. denied, 414 U.S. 908 (1973); *Sanders* v. *John Nuveen & Co.*, 463 F.2d at 1077-1080. See also *Amfac Mortgage Corp.* v. *Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 431-434 (9th Cir. 1978); *Great Western Bank & Trust* v. *Kotz*, 532 F.2d 1252, 1256-1260 (9th Cir. 1976).

Petitioners rely (Becker Br. 30-31) on the fact that the securities acts and the Public Utility Holding Company Act of 1935 contain

C. Commercial Paper Retains The Characteristics Of A Commercial Loan When It Is Purchased By Large, Financially Sophisticated Institutions Other Than Banks; The Bank's Role In The Transaction Does Not Give Rise To The "Hazards" Against Which The Glass-Steagall Act Was Directed

What we have said demonstrates beyond doubt that the sponsors of the Glass-Steagall Act were not targeting the purchase of commercial paper by covered banks. Accordingly, the Act did not intend to embrace commercial paper as a "security," dealing in which was prohibited to commercial banks. That was, of course, at a time when banks were virtually the only purchasers of commercial paper [58] and only very seldom acted as intermediaries for other buyers of this paper. The situation is now markedly changed. Today, the vast bulk of the commercial paper outstanding is held by money market mutual funds, bank trust departments and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations and nonfinancial corporations. The argument is therefore made that the role of the bank in placing this paper with these other purchasers somehow changes its character and brings it within the category of "securities" that the

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specific exemptions from some or all of their provisions for commercial paper as evidence that commercial paper is not excluded from the term "security" as used in the Glass-Steagall Act. But it was Senator Glass himself, the principal draftsman of the Glass-Steagall prohibition on securities activities, that made the proposal to amend the definition of "security" in the 1933 Act to exclude short-term notes on the ground that they did not constitute securities. See *Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933). Contrary to the implication drawn by petitioners, in light of Senator Glass's view, his failure to seek to amend the Glass-Steagall Act to exclude short-term notes from its coverage strongly suggests that he viewed such an amendment as unnecessary because the Act was never intended to cover such instruments.

[58] During the 1930s, banks purchased approximately 95% of the commercial paper sold. A. Greef. *The Commercial Paper House in the United States* 293-297 (1938). Insurance companies, bank trust departments and nonfinancial corporations purchased almost all of the remaining five percent. *Id.* at 303-304.

Glass-Steagall Act forbids commercial banks from dealing in. We now address that contention by showing that commercial paper held by large, financially sophisticated institutions other than banks continues to function as the equivalent of a traditional commercial loan to the issuer and the bank's role in the transaction is in no way inhibited by the Glass-Steagall Act.

1. A commercial loan, in its traditional form, represents a short-term extension of credit to a business to finance short-term needs.[59] By contrast, as we explained above (page 21, *supra*), a debt security such as a bond, debenture or note, ordinarily is distributed to the public, in small denominations, pursuant to a trust indenture, and for relatively long periods of time. The commercial paper involved here exhibits all of the essential criteria of the quintessential commercial loan and bears none of the significant characteristics of a debt security.[60]

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[59] *United States* v. *Connecticut National Bank*, 418 U.S. 656, 665 (1974) ("[c]ommercial loans, generally speaking, are relatively short-term loans to business enterprises of all sizes, usually for purposes of inventory or working capital"). See also D. Hayes, *Bank Lending Policies* 89-91 (2d ed. 1977); J. Culbertson, *Money and Banking* 308-309 (2d ed. 1977). The lower courts have relied on similar criteria to distinguish notes representing commercial loans from "securities" for purposes of the securities acts. See, *e.g.*, *American Bank & Trust Co.* v. *Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d 1247, 1254 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981); *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354, 1359-1361 (7th Cir.), cert. denied, 423 U.S. 825 (1975).

[60] A text on investment banking written by one of the major participants in the drafting of the Glass-Steagall legislation (see 75 Cong. Rec. 10070-10072 (1932) (remarks of Sen. Glass)) states that the most common factor used in approximating the distinction between commercial and investment banking is time—commercial banking involving short-term advances to borrowers and investment banking consisting of long-term advances, usually represented by securities. H. Willis & J. Bogen, *Investment Banking* 5 (1936). See also *Great Western Bank & Trust* v. *Kotz*, *supra*, 532 F.2d at 1257. While we would not single out one isolated characteristic as the determinative indicia of a commercial transaction or an investment, our submission is that the "cluster" of characteristics

First, the commercial paper placed by Bankers Trust matures on the average in 60 days (J.A. 105A); most of the paper placed through dealers has a maturity of 30 days or less.[61] These maturities accord generally with the maturity of a traditional commercial loan from a bank.[62]

As a consequence of its very short maturities, commercial paper, like a commercial loan, generally is held to maturity; there is virtually no secondary commercial paper market.[63] Moreover, also because of its short maturities, the purchasers of commercial paper bear a significantly different *kind* of risk than do investors. Whereas investors must be concerned with the overall, long-term prospects of the issuing business, holders of commercial paper need only be satisfied that the borrowing corporation has sufficient liquidity to meet its current liabilities. In addition, because there is no effective secondary market, holders of commercial paper, like other short-term lenders, generally are not affected by fluctuations in interest rates or other changes in economic conditions that may affect an investor's ability to resell a security. In sum, the risk associated with the purchase of commercial paper in the recognized market is not indicative of an investment transaction.[64]

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of which commercial paper partakes is representative of a traditional commercial loan rather than an investment transaction.

[61] Lowenstein, *supra*, at 147; *The Commercial Paper Market*, *supra*, at 530; Stigum, *supra*, at 632.

[62] See *Terms of Lending at Commercial Banks (August 1-5, 1983)*, 69 Fed. Res. Bull. A25 (Nov. 1983) (weighted average maturity of short-term commercial and industrial loans 1.2 months). The average maturity of commercial paper obligations at the time the Act was passed was approximately five months. Greef, *supra*, at 231.

[63] *The Commercial Paper Market*, *supra*, at 529; Lowenstein, *supra*, at 142; *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 331; Stigum, *supra*, at 641.

[64] Indeed, the risk of loss resulting from the purchase of commercial paper is significantly less even than the risk inherent in ordinary commercial loans extended by banks. See pages 40-42, *infra*.

The "short-term" bonds pointed to by petitioners (SIA Br. 16; Becker Br. 38) have longer maturities than much of the

A final consequence of the very short maturities of commercial paper is that issuers use the proceeds for the same seasonal, temporary purposes as they would use the proceeds of bank loans.[65] The well recognized fact that large corporations issue commercial paper as a substitute for seeking bank credit is additional evidence that commercial paper is the functional equivalent of a commercial loan.[66]

Furthermore, unlike bonds and debentures, commercial paper is sold only in very large denominations—

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paper placed in the commercial paper market today. More importantly, these bonds bear several other characteristics of a security, including distribution to the public in small denominations or issuance under a trust indenture, characteristics not shared by commercial paper.

[65] *The Commercial Paper Market, supra,* at 527; Lowenstein, *supra,* at 131-132. The virtual impossibility of tracing the proceeds of commercial paper (or of a commercial loan) to specific uses (SIA Br. 16) does not mean that commercial paper proceeds may be channeled into long-term assets. Because the purchasers of commercial paper can demand payment within a very short time, a corporation with commercial paper outstanding must maintain sufficient liquidity to meet any short-term demand for payment if, as frequently happens (see pages 4, *supra* & 40-41, *infra*), the corporation's rating is lowered or removed and it can no longer continue to borrow funds in the market.

Moreover, since commercial paper is sold in the recognized market without the registration statement and prospectus otherwise required by the 1933 Act, it must be used to facilitate current business transactions and must have short maturities (less than nine months), be of prime quality, and not ordinarily be sold to the public. See 15 U.S.C. 77c(a)(3); SEC Securities Act Release No. 4412, *supra.* A bank that attempts to distribute as "commercial paper" third party notes that do not have the economic characteristics relied on by the Board thus would be subject to significant risk of criminal and civil liability under the securities laws. See 15 U.S.C. 77*l*(1), 77x. In addition, such a bank would violate the Board's Guidelines and incur the risk of Board supervisory action. See J.A. 187A.

[66] *The Commercial Paper Market, supra,* at 525, 527; Lowenstein, *supra,* at 130. See also American Banker, Sept. 27, 1983, at 3, col. 1 (citing a study finding competition between commercial paper and bank loans as sources of corporate borrowing).

$1,000,000 on the average;[67] Bankers Trust does not sell commercial paper in denominations of less than $100,000 (J.A. 105A). The consequence of the very large denominations in which commercial paper is issued is that it is not affordable by the average investor;[68] Bankers Trust, for example, sells to no individuals (J.A. 106A). Rather, the paper is placed only with large, financially sophisticated institutions (J.A. 106A). The most significant purchasers of commercial paper today are money market mutual funds, which, as of May 1983, held approximately $50 billion in commercial paper, about 30% of the total outstanding.[69] The remaining two-thirds is purchased by bank trust departments and, to a lesser extent, life insurance companies, pension funds, nonprofit organizations, and nonfinancial corporations.[70]

These institutions, like banks, routinely make large purchases of short-term credit instruments as part of a regular business.[71] For example, money market mutual funds are investment companies that, among other things, provide expedited means for making purchases and redemptions of their shares.[72] The funds therefore invest

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[67] *The Commercial Paper Market, supra*, at 528.

[68] *The Commercial Paper Market Since the Mid-Seventies, supra*, at 333-334.

[69] American Banker, July 18, 1983, at 7, col. 1; 69 Fed. Res. Bull. A26 (Oct. 1983). See also *The Commercial Paper Market Since the Mid-Seventies, supra*, at 333.

[70] See, *The Commercial Paper Market, supra*, at 525, 529; *The Commercial Paper Market Since the Mid-Seventies, supra*, at 327, 333-334.

[71] See, *e.g.*, *American Fletcher Mortgage Co.*, v. *United States Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980), cert. denied, 451 U.S. 911 (1981) (commercial loan participation involving bank and nonbank lenders); *Robbins* v. *First American Bank*, 514 F. Supp. 1183, 1186 (N.D. Ill. 1981) (loan participations involving pension funds); *Prudential, Travelers Follow Banks' Path with Short-Term Loans to Corporations*, Wall St. J., Jan. 27, 1983, at 32, col. 2 (short-term commercial loans by insurance companies).

[72] Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *reprinted in Money*

the proceeds from sales of their shares in a variety of short-term credit instruments, such as bankers' acceptances and certificates of deposit as well as commercial paper.[73] Indeed, the Federal Reserve Board determined that money market mutual funds were "creditors" for purposes of the credit control regulations (see 45 Fed. Reg. 17930 (1980)) issued pursuant to the Credit Control Act, 12 U.S.C. 1901 *et seq.* (repealed).[74] Moreover, because they have substantial resources, and have access to professional advice on the money markets, nonbank purchasers of commercial paper, like commercial banks making commercial loans, are able themselves to evaluate the risk of the purchase and to verify representations about the borrowing corporation.[75] Money market funds, for example, have access to a staff of specialists, usually an external adviser, to assist the fund in evaluating the risks of placing funds in particular instruments.[76]

2. Because commercial paper is a unique instrument representative of a commercial loan transaction rather

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Market Mutual Funds: Hearings Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess. 31, 35 (1980).

[73] See Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *supra*, at 32.

[74] The Credit Control Act authorized the Board, at the direction of the President, to "regulate and control any or all extensions of credit" in order to control inflation. 12 U.S.C. 1904 (repealed).

[75] Lowenstein, *supra*, at 143-144, 150, 152 ("[f]rom the viewpoint of a commercial paper purchaser, he is making a short-term commercial loan"). On the other hand, investors ordinarily lack the resources and expertise to make such determinations themselves. Cf. *SEC* v. *Ralston Purina Co.*, 346 U.S. 119, 124-125 (1953).

[76] See Report of the Staff of the Division of Investment Management of the Securities and Exchange Commission, *supra*, at 33-34. Another indicia of a commercial loan is collateralization. See *American Bank & Trust Co.* v. *Wallace*, 702 F.2d at 96; *Great Western Bank & Trust* v. *Kotz*, 532 F.2d at 1258. While commercial paper is not collateralized per se, the existence of backup bank lines of credit in the amount of the issuer's outstanding commercial paper (see pages 4, *supra*, and 41-42, *infra*) provides a degree of assurance of repayment not available in the case of an investment.

than an investment, it is not a security for purposes of the Glass-Steagall Act. It is therefore immaterial whether the bank, in placing the paper, is engaged in an activity that, if conducted with respect to a security, would be prohibited by the Act. In any event, the role played by Bankers Trust is consistent with the view that commercial paper represents a commercial lending transaction. Since the bank places the paper only with a small number of large, financially sophisticated institutions that routinely purchase short-term credit instruments, it in effect is arranging a commercial loan from the purchasers to the issuer. Banks traditionally have performed virtually the same function in arranging loan participations or syndications.[77]

In arranging a loan participation or syndication, the lead bank solicits other lenders wishing to provide funds to a particular borrower and conveys financial information concerning the borrower to the other prospective lenders. The lead bank earns a fee, usually based on the size of the loan, contingent on successful arrangement of the participation.[78] Lenders other than commercial banks frequently are parties to loan participation and syndication transactions.[79] Loan participations and syndications have long been considered part of traditional commercial banking practice and generally are not deemed

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[77] In a syndication, all participating lenders receive a note of the borrower. In a loan participation, the lead lender usually retains the note and issues a separate participation certificate to the other lenders.

[78] See Note, *Loan Participation Agreements as Securities: Judicial Interpretations of the Securities Act of 1933 and the Securities Exchange Act of 1934*, 24 Wm. & Mary L. Rev. 295, 296-297 (1983); Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538 (1977); Comment, *International Loan Syndications, the Securities Acts, and the Duties of a Lead Bank*, 64 Va. L. Rev. 897, 899-900 (1978).

[79] See, *e.g.*, *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d at 1248-1249 (commercial loan participation involving bank and nonbank lenders).

to involve "securities" even under the securities laws.[80]

3. The bank's role in placing commercial paper involves none of the "hazards" that this Court identified in determining that equity interests in a mutual fund were "securities" for purposes of the Glass-Steagall Act in *ICI I*, 401 U.S. at 629-634, 635-638. The principal reason is simply that dealings in commercial paper are relatively risk free.

This lack of significant risk is the product of many factors. First, corporations that borrow in the commercial paper market are rated by five independent credit rating services, which conduct thorough periodic investigations of the issuer's financial condition and liquidity.[81] Paper with no rating or a low rating cannot easily be placed in the market.[82] Accordingly, only the largest and finan-

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[80] See, *e.g.*, *Union Planters National Bank* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174, 1179-1185 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); *American Fletcher Mortgage Co.* v. *United States Steel Credit Corp.*, 635 F.2d at 1253-1255; *United American Bank* v. *Gunter*, 620 F.2d 1108, 1115-1119 (5th Cir. 1980) (disapproving *Lehigh Valley Trust Co.* v. *Central National Bank*, 409 F.2d 989, 992 (5th Cir. 1969), the only court of appeals decision to have construed the securities laws to reach loan participations).

The fact that in arranging for the purchase of commercial paper by other lenders a bank may not purchase the paper for its own account does not alter the underlying character of the bank's activity (in fact, on occasion, Bankers Trust in effect does purchase some of the commercial paper it places by extending a loan to the issuer at or near the commercial paper rate in an amount representing a small portion of the unsold amount of the issue (J.A. 123A)). As we showed above (pages 37-38, *supra*), nonbank purchasers of commercial paper have the financial sophistication to assess the risks of short-term extensions of credit without relying on the judgment of third parties.

[81] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 331; Stigum, *supra*, at 635-637. The rating services are Moody's Investors Service, Standard & Poor's Corporation, Fitch Investor's Service, Duff and Phelps, Inc., and McCarthy, Crisanti, Maffei, Inc. Moody's and Standard & Poor's are the two largest agencies.

[82] *The Commercial Paper Market Since the Mid-Seventies*, *supra*, at 327; Stigum, *supra*, at 635-637. During the past year, a relatively large number of corporations received lower ratings or lost their

cially strongest corporations are able to borrow funds in the commercial paper market.[83] Today, only about 1,200 firms have ratings from the three major credit rating services, thus defining the outer limit of corporations that are able to borrow in the commercial paper market.[84]

Second, the short maturities of the paper provide substantial protection against loss. The large, well-known corporations that use commercial paper to obtain funds are unlikely to deteriorate in 30 to 90 days. Even if financial difficulties do develop, purchasers of the paper, unlike the holders of bonds or debentures, can demand payment before the incipient problems worsen.[85]

Moreover, virtually all commercial paper issuers follow a policy of maintaining lines of credit from a commercial bank equal to 100% of the amount of their commercial paper outstanding.[86] Issuers can draw on these "back-up" lines of credit to repay their outstanding obligations if they encounter financial difficulties. The use of bank

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ratings altogether. From November 1982 to November 1983, Standard & Poor's lowered the rating of 68 corporations and no longer rated an additional 115 firms. Standard & Poor's Corp., *Commercial Paper Ratings Guide* vi-xvi (Nov. 1983).

[83] *The Commercial Paper Market, supra,* at 525, 527-528; Lowenstein, *supra,* at 129; *The Commercial Paper Market Since the Mid-Seventies, supra,* at 328.

[84] *The Commercial Paper Market Since the Mid-Seventies, supra,* at 327, 331. By contrast, approximately 3,000 corporations issue securities that are listed on the Nation's stock exchanges. 1982 SEC Ann. Rep. 106.

[85] For example, the D.H. Baldwin Co., an insurance company that, along with several affiliates, filed for bankruptcy in September 1983 (N.Y. Times, Sept. 27, 1983, at 1, col. 1), at one time was a rated commercial paper issuer. As it developed financial problems, however, Baldwin's rating was lowered in March 1983 and removed in May 1983. Standard & Poor's Corp., *Commercial Paper Ratings Guide, supra,* at xii, x. Thus, assuming Baldwin's paper bore the usual, short maturities characteristic of commercial paper, the paper would have matured before Baldwin's bankruptcy.

[86] *The Commercial Paper Market, supra,* at 530; Goldman, Sachs am. br. 11.

letters of credit also is becoming more widespread in the market. If commercial paper is backed by a letter of credit from a bank or other financial institution, the guarantor agrees to repay the holder of the paper directly if the issuer is unable to do so.[87]

The ultimate test of risk, of course, is the rate of default on commercial paper. Historically, the number of defaults by issuers of commercial paper has been nominal, even during the years of the Great Depression.[88] Indeed, even the 1970 failure of the Penn Central Transportation Company to repay its outstanding commercial paper resulted in the widespread establishment of procedures to assure that borrowers repay their obligations at maturity.[89] Due primarily to the increased surveillance of issuers in the wake of Penn Central, since 1970 there has been no default of significance in the market; the risk of holding commercial paper clearly is no greater now than when the Act was adopted in 1933.[90]

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[87] *The Commercial Paper Market Since the Mid-Seventies, supra*, at 332.

[88] Greef, *supra*, at 311-314. For example, from 1922 to 1935 less than one percent of the firms using the market were unable to repay their paper. *Id.* at 313-314.

[89] Stigum, *supra*, at 635; Lowenstein, *supra*, at 141; see also *The Commercial Paper Market Since the Mid-Seventies, supra*, at 327.

[90] The Penn Central default thus cannot be regarded as representative of the risk associated with the commercial paper market as it operates today. The four other defaults that have occurred since 1970 are de minimis as compared with the total amount of paper outstanding. See Stigum, *supra*, at 635. Moreover, at least one defaulting issuer did not issue the kind of commercial paper involved here, but rather sold obligations to the public generally in denominations as small as $3,000. *Sanders* v. *John Nuveen & Co.*, 463 F.2d 1075, 1079-1080 (7th Cir.), cert. denied 409 U.S. 1009 (1972).

SIA's contention (Br. 17) that the Act provides no exclusion for low-risk securities begs the question. As this Court indicated in *ICI I*, 401 U.S. at 630, risk is one criterion (albeit not the only one) of whether a particular obligation is a "security." Thus, if a low-risk obligation bears other indicia of an investment—for example, if a long-term obligation is distributed to the public in small

Largely for these reasons, a bank's role in placing commercial paper in the recognized market does not give rise to the hazards against which the Act was directed. First, there is no danger that as a result of its commercial paper operations Bankers Trust might be induced to use its depositors' funds to purchase "frozen" or "imprudent stock or security investments." See *ICI I*, 401 U.S. at 630. Although a bank ordinarily would not purchase with its own funds the paper it places—acting instead as the agent of the issuer—where the bank does purchase the paper for its own account such short-term paper clearly is not a frozen or imprudent security investment. Indeed, as we showed above (pages 25-29, *supra*), banks have purchased commercial paper for their own accounts since the beginning of banking in this country; the Act was intended, among other things, to encourage banks to purchase precisely the type of obligation that is involved here.

The low-risk nature of commercial paper also minimizes the possibility of there arising a perceived need for the bank to make a loan to the issuer. In addition, the nature of the commercial paper market reduces the possibility that the bank's involvement in placing the paper would "impair its ability to function as an impartial source of credit." *ICI I*, 401 U.S. at 631. The short-term nature of commercial paper combined with the rating mechanism virtually assures that as soon as a corporation begins to experience financial difficulties it will be unable to continue to borrow in the commercial paper market. Accordingly, there would be little incentive for the bank to "shore up" an issuer in order to be able to continue to place its paper.

Nor is there temptation for a bank to make a loan in order to facilitate the purchase of commercial paper. Because the interest rate on bank loans exceeds the return

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denominations—the instrument may be treated as a security. *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247 (D.D.C. 1966), aff'd *sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968), on which SIA relies (Br. 17 n.19), is inapposite; no claim was made in that case that the obligations at issue were not "securities."

on commercial paper,[91] it is not profitable to purchase commercial paper with borrowed funds.[92]

The uniform financial strength of corporations that issue commercial paper also minimizes the likelihood that purchasers will suffer losses resulting in the bank's "loss of customer good will," that "public confidence in the bank might be impaired," or that the bank's "reputation for prudence and restraint would be damaged" (*ICI I*, 401 U.S. at 631-632). Moreover, not only the financial strength of the issuer, but the nature of commercial paper purchasers as well, render it highly unlikely that a bank would give unreliable investment advice (*ICI I*, 401 U.S. at 633). As we have noted, commercial paper is not offered for sale to the public at large or even to the bank's customers generally, but only to large, financially sophisticated purchasers that regularly purchase in the established short-term credit market. These purchasers have the resources to assess independently any risk posed by the paper.[93]

Finally, the high degree of promotional pressure that is associated with investment banking is not present in the commercial paper market. Rather, fees earned on the placement of commercial paper are relatively modest (usually one-eighth of one percent per year or $1250 per million per year).[94] The placement of commercial paper is by no means a major source of profit, but represents instead a means of encouraging issuers to use the other, more profitable services offered by the placing banks.[95]

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[91] Lowenstein, *supra*, at 130.

[92] J.A. 185A. During its investigation of Bankers Trust's commercial paper activities, the Board staff found "no evidence that purchasers used borrowed funds to buy the commercial paper" (J.A. 106A).

[93] Bankers Trust does not place commercial paper with fiduciary accounts to which the bank provides investment advice. J.A. 106A.

[94] Stigum, *supra*, at 639; Lowenstein, *supra*, at 132.

[95] See Lowenstein, *supra*, at 132.

D. The Board's Determination That The Commercial Paper Involved Here Is Not A "Security" Within The Meaning Of The Glass-Steagall Act Is Entitled To Substantial Deference

Petitioners contend (Becker Br. 23; see also SIA Br. 33-35; Becker Br. 20-24) that the court of appeals "abdicated its responsibility and extended unprecedented judicial deference to the Board's 'adaptation' of the Glass-Steagall Act." To the contrary, the court of appeals expressly declined (J.A. 230A) to "rest merely on the deference to the conclusions of the Federal Reserve Board." Rather, as detailed in the statement above (pages 9-11, *supra*), the court undertook its own independent, extensive analysis of the language, legislative history, and underlying purposes of the Act. As a result, the court concluded (J.A. 230A) that the Board's determination that the commercial paper involved here is not a "security" for purposes of the Act is "essentially correct." But, in any event, the Board's views *are* entitled to substantial deference.

1. We respond first to petitioners' contention (Becker Br. 8-9, 11-20, 41-42; SIA Br. 9, 11-17) that the Board's ruling is entitled to no deference because it represents an impermissible exercise of regulatory authority. Contrary to petitioners' assertions, the Board is not attempting to "regulate" the underwriting by banks of instruments that are securities within the meaning of the Glass-Steagall Act. Rather, as is evident from both the language and the reasoning employed by the Board, its ruling represents a determination that the commercial paper involved here is not a "security" for purposes of the Act and for that reason is not subject to the legislation's prohibitions. See, *e.g.*, J.A. 126A ("[b]ased on a review of all the relevant arguments and the facts of record, the Board is of the opinion that, as a legal matter, the stronger argument is that commercial paper is not a 'security' within the intendment of the Glass-Steagall Act").[96]

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[96] **Nor do the Board's Guidelines amount to regulation of activity that was intended to be prohibited by the Act. As the court of**

Such administrative line-drawing is inherently the function of an agency charged with the administration of a statute, especially one that contains such broad terms as "securities" and "notes." [97] Petitioners' contention that the Board lacks the authority to perform this function is thus nothing more than a restatement of their argument on the merits that every instrument that is denominated

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appeals noted (J.A. 226A n.17), "the guidelines in essence describe Bankers Trust's activities." Accordingly, the additional restrictions imposed by the Board on banks making similar placements (see note 17, *supra*) represent an attempt by the Board to regulate activities *outside* the reach of the Glass-Steagall Act "[p]ursuant to its authority to restrain unsafe or unsound banking practices" (J.A. 183A).

[97] Cf. *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 847-848 (1975) (because Congress "did not attempt to articulate the relevant economic criteria for distinguishing 'securities' from 'nonsecurities'" for purposes of the securities laws, "[t]he task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society come within the coverage of these statutes"). See also *Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946).

Commencing with interpretations contemporaneous with the enactment of Glass-Steagall, the Board has applied the Act on a case-by-case basis depending on the particular facts surrounding individual types of obligations. For example, in 1934, the Board issued an opinion stating that "it is not possible to lay down any general rule as to whether or not certificates of participation based on mortgages, notes issued in series, and other similar obligations secured by mortgages * * * are included within the provisions [of the Glass-Steagall Act] since such obligations vary so widely in character." 20 Fed. Res. Bull. 302 (1934). The Board explained (*ibid.*) that questions concerning the applicability of the Act to these kinds of instruments "must be determined as and when they arise in particular cases according to the facts involved therein." Over the years, the Board has continued to resolve questions involving the coverage of the Act on a case-by-case basis depending on the economic reality of the transaction. See, *e.g.*, 12 C.F.R. 218.109 (short-term unsecured negotiable notes issued by large banks not "securities").

a note is a "security" within the meaning of the Glass-Steagall Act.[98]

2. Properly viewed as the construction of the statute by the agency charged with its administration, the Board's ruling is entitled to considerable deference.[99] Administration of the Glass-Steagall Act is shared between the Board, which enforces the Act with respect to state-chartered banks that are members of the Federal Reserve System, and the Office of the Comptroller, which enforces the Act with respect to national banks.[100] In addition to its significant authority and experience in administering the Glass-Steagall Act in particular,[101] as the Nation's

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[98] Because the Board has not attempted to "regulate" activities that are covered by the Act, petitioners' reliance (Becker Br. 12-16; SIA Br. 22-24) on occasions on which Congress has withheld regulatory authority from the administrative agencies is misplaced. A fortiori, Becker's contention that the Board has unconstitutionally exercised legislative power is frivolous. Moreover, the legislative proposals that preceded enactment of the Glass-Steagall legislation would have required either "federal inspection and constant examination of the affiliates [of banks] and * * * the control of relationships between the parent banks and its associate companies" or federal incorporation (chartering) of affiliates, and had nothing to do with the nature of the activities in which such affiliates could engage. See H. Willis & J. Chapman, *The Banking Situation* 68 (1934). The unsuccessful attempts to amend the Act cited by petitioners (SIA Br. 24; Becker Br. 15) uniformly were intended to permit public underwriting of broad classes of securities that undisputedly were subject to the Act. The failure of Congress to enact such proposals has no bearing on the Board's authority to determine whether a particular instrument is covered by the Act.

[99] See, *e.g.*, *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 31-32, 37-39 (1981); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965).

[100] See *ICI I*, 401 U.S. at 626-627; *Port of New York Authority* v. *Baker, Watts & Co.*, 392 F.2d at 499. The Federal Deposit Insurance Corporation supervises state-chartered banks that are not members of the Federal Reserve System.

[101] For example, the Board is authorized to assess civil penalties for violations of Section 20 of the Act, 12 U.S.C. 377, relating to affiliations between member banks and securities firms, and to provide by regulation for exceptions from the prohibitions of Section

central bank the Board has broad responsibilities in overseeing the entire operation of the country's banking system.[102] Particularly in a case such as this one, where there is no evidence that the transaction at issue was engaged in at the time the controlling legislation was enacted, the Board has the expertise to examine the economic realities of the transaction in order to determine whether the transaction is one that Congress would have intended to reach.[103]

In *ICI II* this Court quoted with approval Justice Rutledge's description of the deference that is due the Board's construction of the Glass-Steagall Act in view of its "specialized experience" (450 U.S. at 56-57 n.21, quoting *Board of Governors of the Federal Reserve System* v. *Agnew*, 329 U.S. 441, 450 (1947) (concurring opinion) (emphasis added)):

32, 12 U.S.C. 78, relating to officer, director, or employee interlocks between a member bank and a securities firm. Becker thus errs in asserting (Br. 22) that the Act is a self-enforcing criminal statute; only one provision, Section 21, of the four key provisions is a criminal statute.

[102] The Board, through the Federal Reserve Banks, examines, supervises and enforces applicable laws with respect to state-chartered member banks as well as bank holding companies. 12 U.S.C. 325, 504, 505, 1818(b), (e), 1844 and 1847. The Federal Reserve System also takes action to control the growth of reserves held by depository institutions, 12 U.S.C. 263 and 461, and extends funds to member banks and other depository institutions, 12 U.S.C. 343 *et seq.*, 352, 357, 461(b)(7).

[103] Petitioners err in suggesting that the Board employed its expert knowledge of economic activities to permit an activity that was prohibited at the time of enactment. As we discussed above, at the time the Glass-Steagall Act was passed banks were virtually the only purchasers of commercial paper; there is no evidence of banks placing third-party commercial paper with other purchasers. The Board's expertise is thus put to use in determining whether, on the basis of the economic realities of the transaction in question, it is one that Congress would have intended to prohibit. By contrast, if petitioners' views were accepted, the universe of financial transactions would be frozen as of the enactment of Glass-Steagall; notwithstanding the considerable expertise and experience available to the Board it would be precluded from determining that any "note" transaction was not within the reach of the Act.

> Not only because Congress has committed the system's operation to their [the Board of Governors of the Federal Reserve System] hands, but also because the system itself is a highly specialized and technical one, requiring expert and coordinated management in all of its phases, I think their judgment should be conclusive upon any matter which * * * is open to reasonable difference of opinion. Their specialized experience gives them an advantage judges cannot possibly have, *not only in dealing with the problems raised for their discretion by the system's working, but also in ascertaining the meaning Congress had in mind in prescribing the standards by which they should administer it.* Accordingly their judgment in such matters should be overturned only where there is no reasonable basis to sustain it or where they exercise it in a manner which clearly exceeds their statutory authority.

In *ICI I*, 401 U.S. at 626-627, as well, the Court recognized the "great weight" that generally is due "any reasonable construction" of the Act by the agencies charged with its enforcement. To be sure, in that case the Court refused to defer to the Comptroller's construction of Sections 16 and 21. But that was because he had "adopted no expressly articulated position at the administrative level as to the meaning and impact of [those provisions]." 401 U.S. at 627. By contrast, here the Board promulgated a statement explaining in detail the reasons for its construction of the Act, "recogniz[ing] and address[ing] the concerns that led to the enactment of the Glass-Steagall Act." *ICI II*, 450 U.S. at 68. That construction, which was entirely consistent with prior rulings concerning commercial paper,[104] is entitled to substantial deference.

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[104] Although this is the first occasion afforded the Board to rule on the precise question presented here, as early as 1971 the Office of the Comptroller had opined that because commercial paper is not a "security" within the meaning of Glass-Steagall, that Act does not prohibit a national bank from acting as a commercial paper dealer. See J.A. 28A-31A.

It is manifest that the recent rulings by agencies other than the Board concerning other types of instruments and activities on

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

REX E. LEE
Solicitor General

RICHARD K. WILLARD
Acting Assistant Attorney General

LOUIS F. CLAIBORNE
Deputy Solicitor General

BARBARA E. ETKIND
Assistant to the Solicitor General

ANTHONY J. STEINMEYER
Attorney

MICHAEL BRADFIELD
General Counsel

RICHARD M. ASHTON
Assistant General Counsel
Board of Governors of the Federal Reserve System

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which petitioners rely (Becker Br. 17-19; SIA Br. 35) have no significant bearing on the lawfulness vel non of the Board's action here. In any event, the legality of these other rulings has yet to be finally determined. Indeed, two courts have upheld administrative decisions permitting banking organizations to offer brokerage services. See *SIA* v. *Board of Governors of the Federal Reserve System*, 716 F.2d 92 (2d Cir. 1983), petition for cert. pending, No. 83-614; *SIA* v. *Conover*, No. 82-2865 (D.D.C. Nov. 2, 1983).

APPENDIX

12 U.S.C. 24 (Seventh), as amended by Section 16 of the Glass-Steagall Act, ch. 89, 48 Stat. 184, provided:

> [A] national banking association * * * shall have power—
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> * * * * *
>
> To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe, but in no event (1) shall the total amount of any issue of investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 10 per centum of the total amount of such issue outstanding, but this limitation shall not apply to any such issue the total amount of which does not exceed $100,000 and does not exceed 50 per centum of the capital of the association, nor (2) shall the total amount of the investment securities of any one obligor or maker purchased after this section as amended takes effect and held by the association for its own account exceed at any time 15 per centum of the amount of the capital

stock of the association actually paid in and unimpaired and 25 per centum of its unimpaired surplus fund. As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus.

The restrictions of this section as to dealing in investment securities shall take effect one year after the date of the approval of this Act.

12 U.S.C. 24 (Seventh), as further amended by Section 308 of the Banking Act of 1935, ch. 614, 49 Stat. 709, provided:

[A] national banking association * * * shall have power—

* * * * *

To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: *Provided*, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on the date of enactment of the Banking Act of 1935. As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association for its own account of any shares of stock of any

corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the Federal Home Loan Banks or the Home Owners' Loan Corporation, or obligations which are insured by the Federal Housing Administrator pursuant to section 207 of the National Housing Act, if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States: *Provided*, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus.

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No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.,*
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,
v.
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.,*
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR A. G. BECKER INCORPORATED

HARVEY L. PITT*
(*Counsel of Record*)
HENRY A. HUBSCHMAN
DAVID M. MILES

FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
(A Partnership Including
Professional Corporations)
Suite 1000
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 342-3500

Counsel for Petitioner
A. G. Becker Incorporated

Of Counsel:

STEVEN M. LOONEY
General Counsel
A. G. BECKER INCORPORATED
55 Water Street
New York, New York 10041
(212) 747-6194

LAURENCE H. TRIBE
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4621

March 14, 1984

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REPLY BRIEF FOR A. G. BECKER INCORPORATED

The Respondents' brief confirms that the majority decision below should be reversed.

ARGUMENT

1. At issue here is the lower court's holding (J.A. 228; 693 F.2d at 141 [1]) that the Federal Reserve Board may "adapt" the flat prohibitions of the Glass-Steagall Act to the Board's subjective notions of "current business reality" and "the changing financial needs of our economy." The Board understandably does not attempt to defend that ruling, presumably because it flies in the face of this Court's repeated holdings to the contrary.[2] Instead, the Board's brief simply ignores it.

Nor does the Board deny that, both at the time the Glass-Steagall Act was adopted and repeatedly thereafter, Congress refused to vest in the Board not only the *precise* rulemaking power the Board has arrogated to itself in this case, but *any* rulemaking power at all.[3] This Court has repeatedly held that the judiciary may not confer legislative power upon an administrative agency that Congress has chosen to withhold.[4]

Nor has the Board offered any convincing explanation why its startling concession—that the plain language of the Glass-

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[1] References to the Joint Appendix and to the parties are the same as in our opening brief. References to A. G. Becker's opening brief are cited as "AGB Br. ." References to the Federal Reserve Board's answering brief are cited as "FRB Br. ." References to the brief *amicus curiae* filed by Goldman, Sachs & Co. are cited as "GS Am. Br. ," and references to the reply brief of the SIA are cited as "SIA Reply Br. ."

[2] *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971) *("Camp"); Board of Governors of the Federal Reserve System* v. *Investment Company Institute,* 450 U.S. 56 (1981) (*"Board of Governors"*).

[3] In 1933, Congress considered permitting commercial banks to engage in the securities business under a system of ongoing federal supervision and *ad hoc* administrative regulation, but rejected that alternative in favor of the prophylactic remedy of absolute prohibition (AGB Br. 11-16). Congress has steadfastly adhered to its initial policy choice ever since, expressly refusing, in 1935, to amend the Act to permit banks "under regulation by the Comptroller of the Currency, to underwrite and sell bonds, debentures, and notes" (AGB Br. at 14), and expressly forbidding the Comptroller, in 1980, to issue any regulations concerning "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act.'" *Id.*

[4] *See, e.g., Pacific Gas & Electric Co.* v. *State Energy Resources Commission,* 103 S.Ct. 1713, 1730 (1983); *Baldridge* v. *Shapiro,* 455 U.S. 345, 358 (1982).

Steagall Act flatly prohibits banks from engaging in the very activity the Board sought to authorize here (J.A. 131)—should not dispose of this case.[5] Both this Term and last, this Court has confirmed the wisdom of precluding administrative agencies from asserting long dormant and unexercised rule-making "authority" belatedly "discovered" to excuse conduct inconsistent with the plain language of the agencies' enabling legislation.[6]

In attempting to justify its refusal to adhere to the plain meaning of the Glass-Steagall Act, the Board now argues only that Congress could not possibly have intended to do what Congress in fact did—prohibit banks from underwriting corporate commercial paper "notes." Even though Congress, in terms, prohibited banks from underwriting any "notes," a term Congress intentionally used broadly, the Board asserts that Congress really must have intended to prohibit banks from underwriting only *those* "notes used to raise capital for an extended period of time as part of a corporation's permanent financial structure," and not what the Board seeks to characterize as "short-term," "risk-free," "commercial" notes (FRB Br. at 15-32).

But, as we explain below, the Board's amorphous "functional analysis" has no basis in law, clashes with economic reality, and would establish *ad hoc* regulation and constant litigation as the primary method of determining whether, when and under what circumstances heretofore Congressionally-prohibited bank securities activities may become permissible by administrative fiat. For all these reasons, the Board's ruling and guidelines are contrary to law and should be set aside.

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[5] The Board's counsel now seeks to reverse field and argue that, perhaps, the Board's unambiguous concession about the plain language of the Glass-Steagall Act was too generous (FRB Br. at 22). It is the Board's position in its ruling, of course, and not the post-hoc rationalization of its counsel, by which the Board's conduct must be judged. *See, e.g., Camp, supra,* 401 U.S. at 627. In any event, concession or not, the plain language of the Glass-Steagall Act prohibits banks from underwriting commercial paper. *See* AGB Br. at 24-29; SIA Reply Br.

[6] *See BATF* v. *FLRA,* 104 S.Ct. 439 (1983); *BankAmerica Corp.* v. *United States,* 103 S.Ct. 2266 (1983); *Motor Vehicle Manufacturers Ass'n* v. *State Farm Mutual Automobile Insurance Co.,* 103 S.Ct. 2856 (1983). *See also, INS* v. *Chadha,* 103 S.Ct. 2764 (1983).

2. Recognizing that its functional analysis is without legal foundation unless the analysis is mandated by statute, the Board claims (FRB Br. 23) that the Glass-Steagall Act itself *compels* the Board to "adapt" the Act to "the changing financial needs of our economy." Because Section 21 prohibits banks from selling "stocks, bonds, debentures, notes, or other securities," and because Section 21 does not expressly define the term "notes," the Board insists that "the statutory text" somehow "directs" the Board to examine all "notes," *on a case-by-case basis,* in order "to determine whether [they] share[ ] that characteristic of an investment that is the common feature of each of the other enumerated instruments" (FRB Br. at 23). According to the Board, Congress intended Section 21 to forbid commercial banks to underwrite only those "notes" which the Board finds to possess that "common feature."

The " 'short answer' " to this argument, of course, " 'is that Congress did not write the statute that way.' " [7] Apart from the fact that Section 21 is not even addressed to the Board, the text of Section 21 neither "directs" the Board to redraft the statutory language nor confers upon the Board the rulemaking authority required to do so. Rather, Section 21 simply but forcefully "directs" commercial banks to refrain from engaging *"to any extent whatever"* in the underwriting of five separate types of financial instruments, one of which is "notes." *See* 12 U.S.C. § 378(a)(1) (emphasis supplied).[8]

But, even if it were assumed that the language of Section 21 *sub silentio* directs the Board to engage in some sort of

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[7] *Russello* v. *United States,* 104 S.Ct. 296, 300 (1983) *(quoting United States* v. *Naftalin,* 441 U.S. 768, 783 (1979)).

[8] The Board's brief belatedly suggests (FRB Br. at 12) that Section 21 should not be deemed to apply to banks at all. That suggestion, of course, was rejected by the Board itself (J.A. 131), is inconsistent with the plain language of Section 21, and twice has been expressly rejected by this Court. *See Board of Governors, supra,* 450 U.S. at 58 n.24; *Camp, supra,* 401 U.S. at 639.

comparative inquiry, the Board's brief is unable to identify "that characteristic of an investment that is the common feature" of "stocks," "bonds," and "debentures":

- the common feature cannot be the form in which the investor receives the return on his investment (FRB Br. at 21), since Section 21 includes securities which pay their return in the form of profits ("stock") and securities which pay their return in the form of interest ("bonds" and "debentures");
- the common characteristic also cannot be the maturity of the security (FRB Br. at 21), because "stock" has no maturity at all, while "bonds" and "debentures" abound in all varieties of maturities; [9]
- the common feature cannot be the existence of a trust indenture (FRB Br. at 21-22), since stock is not issued under a trust indenture, and
- the common feature cannot be registration under the federal securities laws (FRB Br. at 22), because many bonds and debentures never are registered under the federal securities laws.[10]

In truth, the only common feature shared by "stocks, bonds, debentures, notes, or other securities" is that Congress flatly has forbidden banks to underwrite them all "to any extent whatever." *See* 12 U.S.C. § 378(a)(1).

As a result, Congress' failure expressly to define the term "notes" hardly establishes that Congress intended to authorize the Board to abandon the plain statutory language in favor of a functional analysis. Rather, as the Court reiterated just this Term, "[t]his silence compels us to 'start with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used.'"[11] Because the plain and ordinary meaning of the statutory term "notes" encompasses commercial

[9] Indeed, "bonds" and "debentures" with maturities identical to those of commercial paper are widely marketed today, just as they were at the time the Glass-Steagall Act was enacted (AGB Br. at 38 n.65 & Supp. App.).

[10] *See* 15 U.S.C. § 77c(a)(2).

[11] *Russello* v. *United States, supra,* 104 S.Ct. at 300 (*quoting Richards* v. *United States,* 369 U.S. 1, 9 (1962)). *See also, Perrin* v. *United States,* 444 U.S. 37, 42 (1979).

paper, as the Board itself concedes (J.A. 131),[12] that plain statutory language is "conclusive" under the controlling decisions of the Court.[13]

3. Even if it were assumed, *arguendo,* that Congress intended to permit the Board to "adapt" the plain language of the Glass-Steagall Act to "the changing financial needs of our economy" through the application of a standardless functional analysis, the "functional analysis" applied by the Board here is completely inadequate for the task. Whatever revisionist theories one is willing to indulge, there is no basis for assuming that Congress authorized the Board to ignore economic reality, or to promote increased litigation to test whether specific bank activities are permissible or impermissible.

a. Since Congress indisputably enacted the Glass-Steagall Act to insulate commercial banks from the conflicts of interest and other dangers that arise when commercial banks engage in the securities underwriting business,[14] the only functional analysis of commercial paper that could possibly be reconciled with the basic statutory purpose is one which focuses on the function commercial paper serves for the *underwriting bank,* not for the *issuer* of the paper. (*See* AGB Br. at 38-40). When a commercial bank, like Bankers Trust, underwrites commercial paper, it does not purchase commercial paper as part of its traditional lending function, but rather, it engages in the promotional investment banking function of *marketing* commercial paper to investors. *See Camp, supra,* 401 U.S. at 635-38.[15] Proper application of a functional analysis thus confirms

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[12] That Congress intended its words to be given their plain meaning was reaffirmed shortly after the passage of the Act, when Congress, in 1935, itself amended Section 21 to except "mortgage notes" from the statutory bar (AGB Br. at 27-28).

[13] *Board of Governors, supra,* 450 U.S. at 65; *Camp, supra,* 401 U.S. at 639. *Accord,* Comment, 9 Jour. Corp. L. 321, 331-32 (1984) (*"JCL Comment"*); Comment, *Glass-Steagall: A Proposal For Regulation Rather Than Prohibition,* 47 Alb. L. Rev. 1379, 1392 n.79, 1402 (1983) ("*Glass-Steagall: A Proposal For Regulation*").

[14] *Board of Governors, supra,* 450 U.S. at 61-62; *Camp, supra,* 401 U.S. at 630-34.

[15] *Accord,* Orbe, *Glass-Steagall: Lest We Forget,* 11 Fla. St. L. Rev. 163, 195 (1983) ("*Orbe*") ("The commercial bank's basic business is lending and the investment bank's basic business is marketing").

that banks which underwrite commercial paper are engaging in the *marketing* of "notes or other securities," an activity flatly prohibited by the Glass-Steagall Act. *Id.* at 639.[16]

b. The Board's functional analysis also ignores economic reality. Thus, the Board asserts that banks may underwrite commercial paper because these notes constitute the functional equivalent of a bank "loan," which the Board defines as "a *short-term* extension of credit to a business to finance *short-term* needs" (FRB Br. at 34) (emphasis supplied). But, it takes no special expertise to observe that banks today frequently make long-term loans for the aquisition of fixed assets and for permanent increases in working capital, just as they did in the period prior to the passage of the Glass-Steagall Act (GS Am Br. at 17-19).[17]

Moreover, commercial paper plainly is not the equivalent of a bank loan, even on the Board's terms. Thus, for example, although the Board claims that commercial paper is the functional equivalent of a corporate bank loan because the two instruments possess similar maturities (FRB Br. at 35), the Board's own data unmistakably refute this claim and document the frequently gross disparity in their maturities.[18] Equally mistaken are the Board's claims (FRB Br. at 36-37) that

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[16] *Accord,* (J.A. 251; 693 F.2d at 152) (Robb, J. dissenting); *JCL Comment, supra,* at 336; Note, 52 U. Cinn. L. Rev. 618, 633 (1983) ("*Cincinnati Note*") ("[I]t is the promotional role of the bank that is the critical distinction [and] that brings the bank's sale of third party commercial paper within the aegis of [*Camp*] and the prohibitions of Glass-Steagall").

[17] *See* (J.A. 252; 693 F.2d at 151) (Robb, J., dissenting). *Accord,* D. Hayes, *Bank Lending Policies* 89, 107, 109 (2d ed. 1977); G. Munn, *Encylopedia of Banking and Finance* 892 (7th ed. 1973); *Business Loans of American Commercial Banks* chs. 7, 9 (B. Beckhart ed. 1959).

[18] *Compare* 67 Fed. Res. Bull. A26 (Dec. 1981) (average maturity of commercial bank loans is 29.6 months) *with* FRB Br. at 35 (average maturity of commercial paper underwritten by Bankers Trust is 60 days).

commercial paper notes, like corporate bank loans, are issued only in large denominations,[19] and are sold only to institutional investors.[20]

Similarly, there is no basis for the Board's assertion (FRB Br. at 36) that commercial paper and corporate bank loans are customarily used for the same purposes—current, self-liquidating transactions. As the very study endorsed by the Board demonstrates, during periods of tight monetary policy or volatile interest rates, companies which would normally finance their capital expenditures with *long term* debt often turn to commercial paper to avoid committing themselves to high rate financing for extended periods of time.[21]

Finally, the Board's assertion (FRB Br. at 35) that commercial paper resembles a corporate bank loan because there is no secondary market for commercial paper is misplaced. One need look no further than the record in this case, which documents that Bankers Trust itself makes purchases "in the secondary market" of paper it has underwritten for an issuer (J.A. 33) when the original purchaser of the paper has an unexpected need for cash, and that Bankers Trust purchases commercial paper "in the secondary market" on behalf of its parent holding company (J.A. 55).

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[19] Commercial paper actually is sold in denominations as low as $5,000. *JCL Comment, supra,* at 340 n.151; Lowenstein, *The Commercial Paper Market and the Federal Securities Laws,* 4 Corp. L. Rev. 128, 142 (1981) *("Lowenstein")*.

[20] As this Court is aware, commercial paper often is sold to individual investors, *see John Nuveen & Co.* v. *Sanders,* 425 U.S. 929 (1976), *vacating and remanding,* 524 F.2d 1064 (7th Cir. 1975). Indeed, Bankers Trust has touted its ability to sell commercial paper to individual "retail" investors as a primary advantage of the bank's commercial paper underwriting services (J.A. 41).

[21] Hurley, *The Commercial Paper Market Since the Mid-Seventies,* 68 Fed. Res. Bull. 327, 329 (June 1982). *See* Comment, *The Commercial Paper Market and the Securities Acts,* 39 U. Chi. L. Rev. 362, 374, 389 (1972); Davidson, *Liquidity Patterns in Corporate Financing,* Monthly Rev. Fed. Res. Bank Richmond (May 1971), at 2, 3; Schadrack & Breimyer, *Recent Developments in the Commercial Paper Market,* Monthly Rev. Fed. Res. Bank N.Y., 280, 283-86 (Dec. 1970); Snellings, *The Federal Reserve System and the Commercial Paper Market,* J. Comm. Bank Lending, Feb., 1971 at 14, 16. *See also, Lowenstein, supra,* at 128; Dun's Review, *The Case for Commercial Paper,* June, 1968 at 28. *See generally,* GS Am. Br. at 18-21.

c. Acceptance of the Board's functional analysis will result in the piecemeal dismantling of the Act's flat prohibitions. If the Board can equate commercial paper with a corporate bank loan merely because the purchaser of the paper effectively functions as a lender by extending funds to the issuer (FRB Br. at 37-38), then other debt securities, such as bonds, debentures, and "investment notes," could also be deemed the equivalent of a commercial bank loan. This rationale, however,

> would * * * sweep into its coverage almost all devices used by businesses to raise capital—including stocks and bonds—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks.

(J.A. 217; 519 F.Supp. at 615). *Accord, Glass-Steagall: A Proposal For Regulation, supra,* at 1392-93.[22]

d. The Board's functional analysis, if accepted, would institutionalize litigation as the primary determinant of the scope of permissible bank securities activities. *Orbe, supra,* at 189; *Cincinnati Note, supra,* at 635. For example, the Board asserts, and the majority below held, that although the commercial paper at issue here is not a Glass-Steagall Act "security," it may become one if it is "marketed widely" (J.A. 192), is issued in "small[ ] denominations," or is sold "to the general public" (J.A. 250; 693 F.2d at 151).

But, because the Board and the majority never defined the terms "widely marketed," "small[ ] denominations," or "general public," the only manner in which their meaning can be

[22] Although the Board now seeks to avoid this conundrum by asserting that the Glass-Steagall Act permits banks to underwrite only those notes which possess the "cluster" of features possessed by the commercial paper at issue here (FRB Br. at 34 n.60), the recent actions of the federal banking regulators prove that they are adept at stretching the Act even further. *See* CCH Fed. Bank L. Rep. (Current), ¶ 85,432 (1983) (ruling of the Comptroller of the Currency authorizing the mass-marketing by banks of $3,000 interests in notes to unsophisticated individual investors). Moreover, since the Board's "cluster" rationale has no statutory antecedent, those who create the "law" would remain free to "adapt" it to suit their own notions of "the changing financial needs of our economy."

determined is through a series of administrative and judicial proceedings designed "functionally" to "analyze" the facts of each particular case. This process must then be repeated whenever the Board decides to "adapt" its "adaptations" of the Act to meet changing business conditions, or whenever an issue of statutory coverage arises with respect to any instrument of corporate finance.

e. The Board finally argues that its decision to "adapt" the Glass-Steagall Act to "current business reality" is appropriate because, regardless of the plain statutory language or Congress' structural prohibition, the Board believes that bank underwriting of commercial paper will not give rise to the conflicts of interest, financial dangers and other potential abuses Congress intended the Glass-Steagall Act to eliminate (FRB Br. at 40-44). This argument fails for two simple, but fundamental, reasons.

First. As this Court has twice held, Congress enacted the Glass-Steagall Act to exclude commercial banks "completely" and "entirely" from the securities underwriting business because *Congress* determined that bank securities activities necessarily give rise to *"potential"* hazards. *See Board of Governors, supra,* 450 U.S. at 62; *Camp, supra,* 401 U.S. at 635, 639 (emphasis supplied). Since Congress did not authorize the federal banking regulators to override its considered legislative judgment, or to exempt any particular securities activity from the Act's flat prohibition based upon the regulators' assessment of the *actual* dangers involved, the Board's claims of safety, even if they were true, are wholly irrelevant.

Second. The Board's present claims of safety are entitled to no weight since the Board opined earlier in this proceeding that *"the Board is concerned about possible unsafe or unsound practices that would be involved in Bankers Trust's commercial paper activities and in similar activities by any other state member bank"* (J.A. 146) (emphasis supplied). The question posed here, therefore, is not *whether* the hazards the Glass-Steagall Act was designed to prevent are present when banks

underwrite commercial paper—the Board has already conceded that point.

Rather, the question posed here is whether the Board may authorize, under a system of administrative regulation, those activities that Congress has flatly prohibited to banks.[23] Because Congress, in enacting the statute fifty years ago, itself decided that this sort of regulatory approach is inadequate to safeguard against the pervasive and "subtle" hazards Congress feared [24]—a decision Congress has since reaffirmed—the answer to that question plainly is no.[25]

* * * *

The majority opinion below is an anomaly in an otherwise consistent course of judicial interpretations of the Glass-Steagall Act. Its acceptance of the Board's unauthorized assertion of rulemaking power, in the stead of the statute's flat prohibitions, eradicates the critical distinctions and principled methodology that Congress itself embodied in the plain statutory language. Consequently, the decision below will serve as an open invitation to commercial banks to test the regulatory environment by offering products and services flatly prohibited under the

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[23] The Board's *post*-litigation posture should be juxtaposed with the Board's *pre*-litigation pronouncement that, in light of the Board's conclusion that commercial paper does not constitute "notes or other securities," it "does not appear necessary to examine the dangers that the Act was intended to eliminate" (J.A. 140). Post-hoc claims of safety, such as those offered here by the Board, are entitled to no deference at all from the courts, and have been expressly rejected by this Court. *See Camp, supra,* 401 U.S. at 628.

[24] *See* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley); *see also, Camp, supra,* 401 U.S. at 630.

[25] *See Board of Governors of the Federal Reserve System* v. *Agnew,* 329 U.S. 441, 449 (1947) (The Glass-Steagall Act "is a preventive and prophylactic measure"). *Accord, Glass-Steagall: A Proposal For Regulation, supra,* at 1381 ("[N]either the judiciary nor the bank administrative agencies possess any flexibility in applying the Act's * * * restrictions"). In any event, bank underwriting of commercial paper, even under the Board's guidelines, continues to pose the dangers Congress intended the Glass-Steagall Act to eliminate. *See* SIA Reply Br.; *Cincinnati Note, supra,* at 635 ("[T]he Board's guidelines do not begin to eliminate the 'subtle hazards'" involved in bank commercial paper activities).

Glass-Steagall Act. Such a "sell now—litigate later" philosophy can only undermine Congress' structural prohibitions and foment copious litigation.

In sum, the task of "adapt[ing]" the Glass-Steagall Act to the "changing financial needs of our economy" is not one that belongs to the bureaucracy or even to the courts. That task properly lies in the province of Congress, and Congress alone.

CONCLUSION

For each and all of the reasons set forth above and in A. G. Becker's initial brief, the majority opinion below should be reversed, and the Board's ruling and guidelines should be declared null and void.

Respectfully submitted,

HARVEY L. PITT*
(*Counsel of Record*)
HENRY A. HUBSCHMAN
DAVID M. MILES

FRIED, FRANK, HARRIS,
SHRIVER & KAMPELMAN
(A Partnership Including
Professional Corporations)
Suite 1000
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
(202) 342-3500

Counsel for Petitioner
A. G. Becker Incorporated

Of Counsel:

STEVEN M. LOONEY
General Counsel
A. G. BECKER INCORPORATED
55 Water Street
New York, New York 10041
(212) 747-6194

LAURENCE H. TRIBE
1525 Massachusetts Avenue
Cambridge, Massachusetts 02138
(617) 495-4621

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Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF OF BANKERS TRUST COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

JOHN W. BARNUM
(Counsel of Record)
JENNIFER A. SULLIVAN
W. MICHAEL TUPMAN
WHITE & CASE
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 872-0013
Attorneys for Bankers Trust Company as Amicus Curiae

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QUESTION PRESENTED

Bankers Trust Company ("Bankers Trust") adopts the respondents' statement of the question presented: "Whether the court of appeals correctly upheld a ruling by the Board of Governors of the Federal Reserve System that commercial paper—short-term promissory notes issued by large, financially sound businesses in very large denominations to meet their current needs and sold to a small number of financially sophisticated purchasers that regularly purchase short-term credit instruments—is not a security for purposes of the Glass-Steagall Act."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 82-1766

SECURITIES INDUSTRY ASSOCIATION, *et al.*,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL
RESERVE SYSTEM, *et al.*,
Respondents.

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BRIEF OF BANKERS TRUST COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF AMICUS CURIAE

This brief *amicus curiae* is filed with the written consent of all parties on behalf of Bankers Trust Company ("Bankers Trust"), a New York State-chartered member bank of the Federal Reserve System with headquarters in New York City. Bankers Trust acts as agent for certain corporations not affiliated with Bankers Trust that issue and sell commercial paper. The September 26, 1980 statement by the Board of Governors of the Federal Reserve System ("Board") that approved the commercial paper service of Bankers Trust is the subject of the instant litigation. Bankers Trust therefore has a significant interest in this case.

Bankers Trust has participated in the proceedings before the Board, as *amicus curiae* in both the district court and the court of appeals, and in this Court, where it filed a brief *amicus curiae* opposing the joint petition for certiorari. Bankers Trust is familiar with the historical developments in commercial lending that gave rise to its commercial paper service. Consequently the continued participation of Bankers Trust as *amicus curiae* will aid in the fullest possible development of all available information pertaining to the issues in this case.[1]

STATEMENT OF THE CASE

Bankers Trust adopts the respondents' statement of the case.

SUMMARY OF ARGUMENT

1. The decision of the Board treating commercial paper as "promissory notes," and not as either "securities" for purposes of Section 16 or as "notes, or other securities" for purposes of Section 21, gives Glass-Steagall a meaning in accord with its clear purpose. Commercial paper is indeed a note, but the term "notes" in Section 21 does not mean *all* notes, including all commercial credit instruments. Such a construction would lead to the manifestly unreasonable result of prohibiting commercial banks from engaging in a variety of other traditional banking practices such as selling loan participations, bankers' acceptances, and certificates of deposit.

2. Federal banking regulators have always regarded commercial paper as a loan, not as a security. Historically commercial paper has functioned in the nation's financial system as a short-term commercial credit instrument. In economic reality and in legal form it is indistinguishable from a traditional short-term bank loan. The legislative history of Glass-Steagall demonstrates that Congress was fully aware of the role commercial paper played as a credit instrument and that Congress

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[1] Bankers Trust adopts the respondents' abbreviations for petitioners, *i.e.*, SIA and Becker, and refers to their *amici curiae* as ICI and Goldman Sachs.

distinguished between commercial paper and "securities" in the Act. Indeed Congress enacted Glass-Steagall to encourage the return of bank funds from securities activities to commercial loans and commercial paper.

3. Commercial paper does not have the market risk inherent in securities. As so vividly put by Senator Glass,

> a man who makes a loan on commercial paper does not have to stand at a ticker and find out what is going to be the value of it 15 minutes afterwards.

That is the difference between commercial paper and a security.

4. Bankers Trust's commercial paper service does not threaten bank solvency or give rise to any other "hazards" that were the concern of Glass-Steagall. Moreover the Board's Guidelines avoid even "potential" hazards that otherwise might be involved.

ARGUMENT

Introductory Statement

A. The Decision Of The Board

When petitioners requested the Board to prohibit the commercial paper activities of Bankers Trust, the Board and its Division of Banking Supervision and Regulation and its Legal Division[2] devoted two years to a factual study of precisely what Bankers Trust was doing and an analysis of the issues. The Board then ruled that commercial paper is not a "security" for purposes of Glass-Steagall.[3] As stated by the court of appeals:

> Becker and the SIA requested the staff of the Federal Reserve Board to review the legality of Bankers Trust's

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[2] *See* Legal Division, Board of Governors of the Federal Reserve System, *Commercial Paper Activities of Commercial Banks: A Legal Analysis* (June 28, 1979) (R. 338-59).

[3] Federal Reserve System, *Statement Regarding Petitions to Initiate Enforcement Action*, dated September 26, 1980 (J.A. 122A-143A).

> activities. The Board's general counsel, after extensive discussion with Becker, SIA, Bankers Trust and the SEC, issued an opinion declaring that commercial banks may lawfully act as agent for the issuer in the sale of commercial paper, "provided that the sales . . . are limited to purchasers to whom commercial banks normally sell participations in loans." [citation to Legal Division's analysis] Becker and the SIA then requested the Federal Reserve Board to review the decision of its general counsel and to proscribe the commercial paper activities of member banks. After considering submissions by interested parties and conducting an on-site investigation of Bankers Trust's activities, the Board ruled that Bankers Trust's participation in the commercial paper market did not violate the Glass-Steagall Act. . . . (J.A. 224A)

Later the Board issued guidelines ("Guidelines") to make it clear that its decision related only to commercial paper that is exempted from registration under the Securities Act of 1933 by Section 3(a)(3) of that Act. 15 U.S.C. § 77c(a)(3) (1980).[4]

The decision of the Board that commercial paper is not a security is entirely consistent with the language of Sections 16 and 21 of the Glass-Steagall Act. After recognizing that a reading of the statute "that would thwart the clear purpose of the Act and that leads to irrational results . . . . cannot be dispositive of whether commercial paper is a security under the . . . Act" (J.A. 132A), the Board applied its expert knowledge of the banking business by making a "functional" analysis of whether commercial paper was more like a loan than a security. In reaching its conclusion the Board analyzed the history of commercial paper, the legislative history of Glass-Steagall, the statute itself, and commercial paper as a commercial credit instrument.

In responding to petitioners' objections the Board did not assume the authority to rewrite Glass-Steagall. It recognized that the statute had to be interpreted as to whether "secur-

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[4] *See* Federal Reserve System, *Policy Statement Concerning the Sale of Third-Party Commercial Paper by State Member Banks*, 46 Fed. Reg. 29333 (May 26, 1981) (J.A. 183A-189A).

ities" included commercial paper, just as it has interpreted the statute with respect to other credit instruments. It investigated the facts, analyzed the legal and policy issues, and issued "a carefully reasoned opinion." J.A. 224A. It is the expert in the business of banking and its decision merits support.

B. Opinions Of The Lower Courts

It is as important to understand what this case is *not* about as it is to understand what it is about. Affirmance of the court of appeals' decision will *not* allow Bankers Trust or any other commercial bank to underwrite stocks, bonds, notes with maturities over nine months, or other securities. Affirmance of the court of appeals' decision will *only* allow commercial banks to underwrite commercial paper that is exempted from registration under the Securities Act of 1933 by Section 3(a)(3).

The district court properly posed the question to be addressed as "whether commercial paper is in fact a 'note or other security' for purposes of the Glass-Steagall Act." J.A. 210A. In its footnote 10 the district court specifically disclaimed reaching the question whether Bankers Trust's commercial paper activities constituted "underwriting." J.A. 217A. Notwithstanding, the district court analyzed the case in terms of the question it did *not* answer, which we believe contributed greatly to the district court's incorrect conclusion. For example, the district court first noted that: "In the plaintiffs' view what distinguishes Bankers Trust's conduct from other, more traditional banking functions, is the unique role of Bankers Trust, functioning between the issuer and the purchaser of commercial paper." J.A. 210A-211A. The district court then proceeded to analyze the "role of Bankers Trust," stating:

> The problem with the Board's analysis emerges instantaneously: it ignores the specific conduct of the bank . . . . The Board's analysis would also sweep into its coverage almost all devices used by businesses to raise capital—*including stocks and bonds*—transforming transactions unquestionably at the heart of the securities industry into permissible activity for commercial depository banks

. . . . One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and that crucial aspect is the role of Bankers Trust in the transactions.[10]

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[10]The Court, like the Board, does not reach the question whether Bankers Trust was actually underwriting securities in violation of the Glass-Steagall Act. The question presented herein is whether the Board erred when it concluded that commercial paper was not a security under the Act. Although the Court has offered various characterizations to Bankers Trust's conduct, by no means does this opinion mean to convey that the bank was underwriting securities. (J.A. 217A-218A) (Emphasis added.)

In its footnote 10 the district court recognized that it was not deciding whether Bankers Trust was "underwriting securities in violation of the Glass-Steagall Act," but only whether "commercial paper was . . . a security under the Act." *Id.* However, the damage had been done; by mixing its analysis of the instrument with an analysis of the bank's role the district court reached the wrong conclusion on the only question actually presented.

The majority of the court of appeals concentrated on the question whether commercial paper is a "security" for purposes of Glass-Steagall. The dissent, however, also chose to look at the role of Bankers Trust in the transaction as being the "critical distinction between commercial banking and investment banking" (J.A. 251A), rather than looking at the instrument itself.

Petitioners in their briefs and oral arguments below have presented and here continue to present the issues as if the two questions were but one. They are not. Whether Bankers Trust's commercial paper activities are "underwriting" within the meaning of Glass-Steagall is a separate question from whether commercial paper is a "security" within the meaning of Glass-Steagall, and it is only the latter question that is before the Court in this case. To meld the two questions only leads to confusion, such as the district court's conclusion that a decision that commercial paper is not a "security" for purposes of Glass-

Steagall will allow banks to underwrite "stocks and bonds." J.A. 217A. Nothing could be further from the truth.

It is particularly important to look at the instrument itself in deciding this case.[5] If the Court examines the instrument itself and concludes, as the court of appeals properly concluded, that commercial paper is not a "security" for purposes of Glass-Steagall, that is the end of the inquiry.

C. The Bankers Trust Commercial Paper Program

In the program under attack Bankers Trust as agent for the issuer sells only prime quality negotiable promissory notes that are exempt from registration under Section 3(a)(3) of the Securities Act of 1933. In order to qualify for that exemption the proceeds of the paper must be used for "current transactions" of the issuer and the maturity of the paper must not be over nine months.[6] Bankers Trust handles only highly rated issuers that have 100 percent commercial bank back-up lines of credit for the paper being handled. In addition the paper must be sold to financially sophisticated customers, such as institutional purchasers, and the paper is issued only in denominations of $100,000 or more. Guidelines ¶ 1, J.A. 187A. The average denomination is $1,000,000 or more. J.A. 245A at n.81.

It is not accidental that the instrument in question is called commercial paper and that Bankers Trust is a commercial bank. Short-term promissory notes such as commercial paper have long been the premier instruments to which commercial banks have committed their funds and which they have bought

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[5] The nature of the instrument is in fact a key to distinguishing between commercial and investment banking. As a text on investment banking written in 1936 states, the most common factor used in making a rough practical distinction between commercial and investment banking is that of *time*—commercial banking involving short-term advances to borrowers and investment banking involving long-term advances usually represented by securities. H. Willis and J. Bogen, *Investment Banking* 6 (rev. ed. 1936).

[6] 15 U.S.C. § 77c(a)(3) (1980).

and sold. No one would dispute that a commercial bank may purchase a commercial paper note directly from an issuer and hold it to maturity. It seems ironic for petitioners to claim that somehow commercial paper becomes too risky or is otherwise inappropriate for a commercial bank to sell whenever the issuers of such notes attain sufficient financial strength to be able to sell their notes directly to sophisticated purchasers, rather than borrowing on the same note from a commercial bank.

Regardless of the outcome of this case, commercial banks will continue to assume the credit risk of commercial paper by purchasing it or by extending back-up lines of credit. As stated by Goldman Sachs (Br. 11),

> Commercial paper issuers are required in nearly all instances to arrange back-up bank lines of credit equal in amount to 100 percent of the face value of the commercial paper to be marketed. That is, the issuer must arrange for a commercial bank to provide stand-by lending authority sufficient to cover the full amount of the commercial paper when it comes due.

Thus the banks will continue to be the ultimate lenders and the ultimate risk takers in commercial paper transactions.[7] If they are already at risk on the issuer's credit, to prohibit commercial banks from acting as the issuer's sales agent on the ground that it will expose the banks to hazards that Congress sought to avoid would honor form over substance.

Commercial banks have been buying and selling commercial paper for more than a hundred years.[8] Although most of the purchasers of commercial paper from banks used to be other

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[7] *See* Hurley, *The Commercial Paper Market since the Mid-Seventies*, 68 Fed. Reserve Bull. 327, 333 (1982).

[8] *See* A. Greef, *The Commercial Paper House in the United States* 45-51, 379 (1938). SIA only asserts that banks did not *regularly* distribute commercial paper before Glass-Steagall (*see* Br. 15 n.14, emphasis changed from "not" to "regularly") and its assertion that banks did not underwrite such paper after Glass-Steagall ignores the Comptroller's 1971 ruling that permitted "dealing" and therefore "underwriting." J.A. 28A. *See* pages 19-20, *infra*.

banks, there were non-bank purchasers even prior to the enactment of Glass-Steagall.[9] In recent years not only has the commercial paper market grown but the amount of paper purchased by non-banks has grown too.[10]

The issuers of commercial paper are the banks' present and former prime commercial borrowers.[11] The purchasers of commercial paper are often institutions that formerly kept their excess or unneeded funds on deposit with the banks.[12] When the banks realized in the 1970s that their prime borrowers were unlikely to return to their former borrowing habits, the banks attempted to adjust. Some banks attempted to compete by making loans at or near the commercial paper rate, and in the late 1970s considerable below-prime lending developed.[13]

For its response Bankers Trust decided to capitalize on its expertise in the money market, basically a market for short-term credit instruments,[14] by assisting its customers and for-

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[9] Although nonfinancial corporations have been purchasers for well over 50 years, in the 1930s they were a small part of the market. *See Greef*, *supra* note 8, at 96, 292.

[10] From approximately $15 billion in 1966, commercial paper increased to $64.6 billion in 1977 and to $180.7 billion in 1982, approximately where it remains today. *See* M. Stigum, *The Money Market* 627-28 (rev. ed. 1983); Fed. Reserve Bank of N.Y., Weekly Release, Commercial Paper Outstanding (Dec. 21, 1983).

As of 1981 approximately 95 percent of all commercial paper was held by non-bank purchasers. *See* Abken, *Commercial Paper*, Fed. Reserve Bank of Richmond Econ. Rev. 11, 13 (Mar./Apr. 1981).

[11] *See* Hurley, *The Commercial Paper Market*, 63 Fed. Reserve Bull. 525, 527 (1977); Abken, *supra* note 10, at 15.

[12] *Id.* at 14.

[13] *Id.* at 17.

[14] The money market consists mostly of short-term U.S. Treasury and agency debt, bankers' acceptances, certificates of deposit, municipal notes, and commercial paper. *See* Stigum, *supra* note 10, at 1, 30-43. The form of marketable Treasury obligations depends on the

mer borrowers in the sale of their commercial paper. The instrument is one that Bankers Trust has bought and sold for its own account for years and for which the bank has provided and is providing billions of dollars of back-up credit. Thus Bankers Trust is fully familiar with commercial paper and the bank's program developed as a direct result of the growth of the commercial paper market and the bank's desire to continue to help provide short-term financing for its prime customers.

D. The Securities Industry Is Attempting To Eliminate Competition.

Petitioners and their *amici* are trying to use Glass-Steagall for a purpose not intended, that is, in order to lessen their competition they are attempting to drive banks out of part of the banking business.[15] If petitioners and their *amici* are successful in this attempt, they will have changed more than a century of commercial banking practice, including the practices of the 50 years since Glass-Steagall was enacted.

When banks were dealing in commercial paper on an occasional basis, the investment bankers did not attack the regulatory rulings such as the ruling in 1971 of the Office of the Comptroller of the Currency ("Comptroller") (J.A. 28A; *see* pages 19-20, *infra*).[16] When the commercial paper market ex-

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length of time for which they are issued and they are designated accordingly. Treasury *bills* have a maturity at issue of a year or less; Treasury *notes* have a maturity at issue of 1 to 10 years; and Treasury *bonds* have a maturity at issue of 10 years or more. *Id.* at 30.

[15] The investment banks that participate in commercial paper transactions are in fact performing the traditional lending functions of commercial banks, rather than their own traditional function of facilitating long-term capital financing. *See* R. Foulke, *The Commercial Paper Market* 134 (1933); Greef, *supra* note 8, at 378-79.

[16] SIA argues (Br. 27 n.35) that Congress in 1980 specifically denied the Comptroller any authority to regulate the securities activities of national banks under Glass-Steagall. More significant, however, is the fact that Congress did not disturb the Comptroller's "long-standing" view that commercial paper are loan assets, not securities. *See* J.A. 28A.

panded, however, and Bankers Trust attempted to retain its high-grade clientele by servicing their commercial paper needs, the investment banking industry sought to squelch the competition. Their attack is against the public interest. Increased competition, which classically reduces prices, will be a benefit both to the economy in general and to the issuers and purchasers of commercial paper in particular.

Glass-Steagall was not intended to bar commercial banks from traditional commercial banking activities and Congress never intended to protect investment bankers from competition.[17] Bankers Trust is not attempting to encroach on the investment banking industry. It is simply attempting to maintain its traditional business involving short-term lending and short-term credit instruments.

I.

The Language Of The Glass-Steagall Act Permits Banks To Sell Promissory Notes Such As Commercial Paper.

In determining what kinds of notes Congress intended to include within the prohibitions of Section 21 of Glass-Steagall the term "notes" must be viewed in the context of the words around it: "stocks, bonds, debentures, notes, or other securities." *See Jarecki* v. *G.D. Searle & Co.*, 367 U.S. 303, 307 (1961).[18] As this Court said in another federal banking statute case, "words grouped in a list should be given related meaning." *Third National Bank in Nashville* v. *IMPAC Ltd.*, 432 U.S. 312, 322 (1977).

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[17] "[N]either the language of the pertinent provisions of the Glass-Steagall Act nor the legislative history evinces any congressional concern for . . . freedom from competition." *Investment Company Institute* v. *Camp*, 401 U.S. 617, 640 (1971) (Harlan, J., dissenting on the issue of petitioners' standing).

[18] We limit our discussion to "notes, or other securities" in Section 21 because "securities" in Section 16 would not be broader than "securities" in Section 21.

By including these companion words Congress evidenced its intent to prohibit banks from underwriting, selling, or distributing notes that have the same economic characteristics as stocks, bonds, and debentures and hence are in the nature of a security, as distinguished from notes that are commercial credit instruments and hence are in the nature of a loan. Commercial paper is not a note in the nature of a security, but rather is a promissory note that has the economic characteristics of a traditional short-term loan.

Relying on *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) ("*ICI I*"), petitioners contend, however, that this Court has instructed that Sections 16 and 21 of Glass-Steagall are to be construed "broadly" and their terms applied "literally." Becker Br. 26; SIA Br. 12-13. In *ICI I* this Court held that the term "securities" could not be construed so narrowly as to exclude participating interests in an open-end stock fund. But it does not follow that the term should be expanded to encompass commercial credit instruments.[19]

Petitioners argue that a functional analysis of commercial paper is unnecessary and improper because Glass-Steagall "flatly and unambiguously" prohibits banks from selling "all"

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[19] In addition to *ICI I*, SIA cites three other cases in support of the argument that the term "securities" in Glass-Steagall should be construed "broadly." SIA Br. 12.

In *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46 (1981), this Court simply noted that in *ICI I* it had relied upon the "literal" language of the Glass-Steagall Act. 450 U.S. at 65. The issue of whether terms in the Act should be construed narrowly or broadly was not considered because "[n]o one could dispute" that the instruments in question were "securities." *Id.* at 66.

In the other two cases, *Board of Governors* v. *Agnew*, 329 U.S. 441 (1947), and *Awotin* v. *Atlas Exchange Nat'l Bank of Chicago*, 295 U.S. 209 (1935), construction of the term "securities" in the Act was not at issue. *Awotin* actually involved the McFadden Act, enacted by Congress in 1927 and then later incorporated into and amended by Glass-Steagall.

notes. SIA Br. 17; Becker Br. 27. But the statute does not say "all" notes or "any" note. Rather the undefined term "notes" is modified by its companion words "stocks, bonds, debentures, . . ., or other securities."[20] In determining whether a particular note is in the nature of a security like stocks, bonds, and debentures, a functional analysis is therefore both necessary and appropriate.

In interpreting the term "notes" in Glass-Steagall the Board relied on its expert knowledge of commercial banking to examine the function of commercial paper in the nation's financial system. The Board's functional analysis was essential to its interpretation, and it is that functional analysis—as well as the Board's factual investigation—that is entitled to respect. The Board is the agency charged with overseeing the administration of proper banking practices of member banks and ensuring the safety and soundness of our commercial banking system. As this Court said in *ICI I:*

> It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. 401 U.S. at 626-27.

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[20] Becker tries to ignore the complete list in Section 21 of Glass-Steagall by repeatedly quoting the phrase "notes or other securities" [sic] as the only language to be construed. *E.g.*, Becker Br. i, 8, 21, 25. (Becker usually omits the comma following the word "notes" in Section 21.) Similarly SIA focuses almost exclusively on the two words "notes" and "securities" in an attempt to construe those terms in isolation. *E.g.*, SIA Br. 2, 8, 13, 17.

Becker argues that the juxtaposition of the terms "notes" and "other securities" demonstrates that all notes, including commercial paper, are "included within the generic definition of the broader term 'securities.'" Becker Br. 26. The term "notes," however, is itself quite broad and, given all meanings, would embrace bonds and debentures, making their inclusion in the list redundant. Accordingly, as a general term "notes" should be construed to embrace only "items akin to those specifically enumerated." *Harrison* v. *PPG Indus., Inc.*, 446 U.S. 578, 588 (1980).

Petitioners and their *amici* have nevertheless argued (*e.g.*, Becker Br. 22-24, SIA Br. 33-34) that no deference is due the Board and its banking expertise because Glass-Steagall is not a regulatory statute. In *ICI I* the Court rejected the Comptroller's Glass-Steagall ruling not because he was not entitled to deference, but because "the Comptroller adopted no expressly articulated position at the administrative level." 401 U.S. at 627. Here the Board examined the issues and issued a 28-page decision. In addition, with the statute expressly authorizing "carry[ing] on the business of banking" by discounting and negotiating "promissory notes," and with an apparent conflict between that use of the word "notes" in Section 16 and the use of the word "notes" in Section 21, it would appear to be the very case in which to rely on the banking expertise of the Board.

This Court has never had occasion to construe the phrase "notes, or other securities" as used in Section 21. Thus, in the words of this Court, "[t]his case presents an entirely different issue" from the issue presented in *ICI I*. *See Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 66 (1981) ("*ICI II*"). More important, unlike the situation in *ICI I*, construction of the phrase "notes, or other securities" in Section 21 to include the instrument at issue not only would conflict with "notes" in Section 16 but would frustrate "the business of banking."

This Court has already emphasized that Glass-Steagall "surely was not intended to require banks to abandon an accepted banking practice." *ICI II*, 450 U.S. at 63.[21] If the phrase "notes, or other securities" in Section 21 were construed to mean all notes it would include a number of commercial credit instruments that banks have sold for over one hundred years.

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[21] Becker incorrectly states that *ICI II* is not "controlling" because it involved the Bank Holding Company Act, not the Glass-Steagall Act. Becker Br. 41 n.72. In fact *ICI II* raised issues under both Acts and this Court discussed the Board's guidelines regarding bank investment advisory services in the specific context of Glass-Steagall. 450 U.S. at 66-67.

The effect would be to eviscerate traditional bank functions by prohibiting such unquestioned and unquestionably lawful activities as buying and reselling loans, bankers' acceptances, and certificates of deposit, as well as prohibiting banks from purchasing commercial paper for their own account. In order to avoid giving "unintended breadth to the Acts of Congress," *Jarecki* v. *G.D. Searle & Co.*, 367 U.S at 307, the scope of the phrase "notes, or other securities" must be limited by reference to the companion words "stocks, bonds, debentures," so as not to include notes that are commercial credit instruments.[22]

Petitioners and Goldman Sachs have struggled unsuccessfully with the language of 12 U.S.C. § 24 Seventh as amended by Section 16 of Glass-Steagall.[23] They have tried in several

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[22] Becker also argues that because in 1935 Congress expressly "excluded" mortgage notes from the coverage of Section 21, exclusion of other notes cannot be implied, Becker Br. 27-28. In fact Congress did not "exclude" mortgage notes, which banks had always been authorized to sell (*see* note 23, *infra*), but rather simply clarified that Section 21 did not limit "such rights as banks may otherwise possess to sell obligations evidencing loans on real estate." S. Rep. No. 1007, 74th Cong., 1st Sess. 15 (1935). A statutory exclusion would be necessary only for those notes in the nature of a security, and Congress may well have thought that a mortgage note—usually an instrument with a term of several years—might otherwise be considered a note in the nature of a security. *Cf.* note 5, *supra*. Congress did not have any corresponding reason to clarify the meaning of "notes" to exclude certificates of deposit, bankers' acceptances, or commercial paper, which are unmistakably commercial credit instruments.

[23] *See* Becker Br. 28 n.45; Goldman Sachs Br. 21-23.

The first two sentences of 12 U.S.C. § 24 Seventh read in pertinent part as follows:

> Seventh. To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; . . . The business of dealing in securities and stock by the [bank] shall be limited to purchasing and selling

ways to explain how commercial banks can continue to deal in loan participations, bankers' acceptances, and certificates of deposit under Paragraph Seventh, even though they take the position that the authority to carry on the business of banking by discounting and negotiating promissory notes does not apply to commercial paper.[24] They have not provided a good explanation, especially with respect to loan participations. Their problem, which was recognized by both the Board and the court of appeals, is that there is no material difference between these other bank instruments and commercial paper.

> such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock. . . .

Becker contends that the authority to discount and negotiate notes does not empower banks to sell notes. Becker Br. 28 n.45. One of the very cases cited by Becker is to the contrary. In *First Nat'l Bank of Hartford* v. *City of Hartford*, 273 U.S. 548 (1927), this Court rejected the argument that the National Bank Act did not authorize banks to sell such notes as "mortgages and other evidences of debt" acquired by loan or discount. 273 U.S. at 560. Banks therefore were free to compete in the "business of acquiring and selling" such notes.

[24] Goldman Sachs contends that these traditional bank functions would not be prohibited because the National Bank Act expressly authorizes banks to issue and purchase notes, while Glass-Steagall merely prohibits the sale of notes. Goldman Sachs Br. 21-23. If Glass-Steagall prohibits the sale of notes, however, banks would be barred from such traditional bank activities as the sale of loan participation certificates and bankers' acceptances. Furthermore, if notes like commercial paper are "securities" for purposes of Glass-Steagall, then banks would be prohibited from purchasing commercial paper for their own account because banks are authorized to purchase only "investment securities" for their own account. 12 U.S.C. § 24 Seventh. Congress did not consider or intend commercial paper to be within the definition of "investment securities," 67 Cong. Rec. 3232 (1926), and neither did the Board. *See* Board letter to Congress in *Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 180 (1933); *Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 120 (1933).

In the typical loan participation the bank makes or buys a loan and then sells "participation certificates" that formalize the legal rights and obligations of the participants.[25] Banks have long sold loan participations where, because of the need for liquidity or the need to spread risks, a single bank is unable or unwilling to make the entire loan. Banks also sell participations as an accommodation to a purchaser that would like to earn interest on its funds.[26] Thus participation certificates and commercial paper are functionally similar loan instruments.[27]

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[25] *See* Thuleen, *Survey of Practice and Procedure of Banks in Taking Participations from Correspondent Banks*, 50 J. Com. Bank Lending 10, 17-18 (1968). Certificates that evidence loan "participations" may evidence the sale of part or all of a loan. If the whole loan is sold through a participation, the transaction is known in the banking industry as a "100% participation."

[26] *See* Armstrong, *The Developing Law of Participation Agreements*, 23 Bus. Law. 689 (1968). Consequently "some commercial banks purchase loan participation interests as a substitute for commercial paper purchases." Legal Division, *supra* note 2, at 6 (R. 344).

[27] Goldman Sachs concedes that banks historically sold commercial paper to other banks and that such "participations" closely resemble the participations of loans, which is "entirely consistent with the banks' recognized and traditional lending function." Goldman Sachs Br. 26 (emphasis deleted). Goldman Sachs contends, however, that commercial paper and loan participations include only bank participants, in contrast to Bankers Trust's commercial paper sales that involve non-bank participants. Goldman Sachs Br. 23 n.13. To the contrary, as the Board recognized in its analysis, loan participations are in fact sold to all kinds of institutional purchasers. *See* Legal Division, *supra* note 2, at 4 and n. 13 (R. 342). (*See also* note 3, *supra*.) The courts have also recognized that loan participations commonly involve participants other than banks. *See, e.g.*, *Union Planters Nat'l Bank of Memphis* v. *Commercial Credit Business Loans, Inc.*, 651 F.2d 1174 (6th Cir.), *cert. denied*, 454 U.S. 1124 (1981) (finance company); *American Fletcher Mortgage Co.* v. *U.S. Steel Credit Corp.*, 635 F.2d 1247 (7th Cir. 1980), *cert. denied*, 451 U.S. 911 (1981) (mortgage company, finance company, and trust company); *Robbins* v. *First Am. Bank of Va.*, 514 F. Supp. 1183 (N.D. Ill. 1981) (union pension fund).

Bank sales of commercial paper are also functionally similar to the sale of bankers' acceptances. A banker's acceptance is "one type of a broad class of credit instruments known as bills of exchange" which are used mostly to finance imports and exports.[28] Typically a bank arranges to pay for the incoming goods of a creditworthy importer through a draft drawn on it by the exporter. If the lending bank agrees to extend credit to the importer for the amount of the goods, it often chooses not to hold the draft for the duration of the financing but to stamp the draft "accepted" and to resell the acceptance in its entirety or to fractionalize the acceptance by selling participations in it. Commercial banks may sell not only their own acceptances on which they are liable, but they can and do trade in acceptances of other banks on which the trading bank is not liable. In selling acceptances, as in selling loan participations, a bank is simply diversifying its lending base or redistributing loans to more willing lenders; the bank has made or bought a loan and it is selling all or a part of it.[29] The Comptroller has determined that bank sales of acceptances and participations in acceptances are "permissible under the Glass-Steagall Act" because the "express power under 12 U.S.C. § 24 (Seventh) to discount and negotiate drafts and bills of exchange squarely empowers a national bank to buy and sell acceptances created by any bank."[30]

This Court has emphasized that the prohibitions of Glass-Steagall do not extend to activities that "are not significantly different from the traditional . . . functions of banks." *ICI II*,

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[28] J. Joines, "Bankers' Acceptances," *Instruments of the Money Market* 77 (4th ed. 1977).

[29] *Id.* at 75-76. *See* The Bond Buyer, Aug. 30, 1983, at 1.

[30] Letter dated August 4, 1983 from the Comptroller to [name of addressee-bank deleted in copy of letter made publicly available], [Current] Fed. Banking L. Rep. (CCH) ¶ 85,432, at 77,570. *See also* Letter dated June 8, 1934 from the Secretary of the Board of Governors to the Federal Reserve Agent, Federal Reserve Bank of New York (bankers' acceptances are not "securities" for purposes of the Glass-Steagall Act).

450 U.S. at 55. The economic reality of a bank's selling commercial paper that a customer has issued or that the bank has purchased, like the sale of loan participations and bankers' acceptances, is that the bank is selling a commercial credit instrument. Selling commercial credit instruments like those discussed above—including commercial paper—in order to diversify, create liquidity, or accommodate an issuer or a purchaser is part of the traditional functions of banks and is a lawful activity under Glass-Steagall.

II.

Commercial Paper Functions As The Equivalent Of A Commercial Loan.

As stated by the Board in its decision in 1980, "it has been the consistent and uniform practice of the bank regulatory agencies for almost 50 years to consider commercial paper as a loan . . . ." and "[t]he present attitude of the bank regulatory agencies is consistent with the view that commercial paper is properly viewed as a loan . . . . The instructions of each of the three federal banking agencies for preparation of call reports direct that commercial paper be treated as a loan." J.A. 129A, 130A.[31]

Similarly in ruling in 1971 that a commercial bank may lawfully act as a dealer in—that is, a buyer *and* seller of—commercial paper, the Comptroller said:

> [Y]ou inquire whether dealing in commercial paper would constitute dealing in securities prohibited by the Glass-Steagall Act, 12 U.S.C. 377, 378, 78 and 24. The answer to this question depends on whether note obligations commonly known as commercial paper are considered securities for this purpose. This office has taken the posi-

[31] A "call report" is a "[s]tatement of condition of a bank submitted in response to calls by the supervisory authorities . . . . on a specified form in accordance with instructions. . . ." G. Munn and F. Garcia, *Encyclopedia of Banking and Finance* 155 (8th ed. 1983). Bank accountants also treat commercial paper held by the bank as a loan in bank financial statements.

> tion that such obligations are not "securities" for the purposes of the Glass-Steagall Act, provided such notes are exempt from registration under Section 3(a)(3) of the Securities Act of 1933, and that a national bank may deal in such exempt securities. *The long-standing position of the office is that commercial paper are loan assets.* . . . (J.A. 28A) (Emphasis added.)

Since both the Board and the Comptroller treat commercial paper as an unsecured loan (J.A. 130A), a commercial bank that purchases commercial paper must keep the commercial paper of any corporate issuer held by the bank at any one time, plus all other outstanding extensions of credit to that corporation, within the unsecured lending limit of the bank. A piece of commercial paper is in fact indistinguishable in substance from a note taken by a commercial bank to evidence a traditional short-term loan. Often they are both evidenced by an identical piece of paper. Therefore, if the bank reaches its lending limit for a corporation, it must either sell the commercial paper or another commercial loan that it had previously acquired from the corporate issuer or stop buying the issuer's new paper until the loan evidenced by the paper that the bank owns matures. When one combines the generally very short maturity of commercial paper (the average maturity is less than 30 days)[32] with the lending limit restrictions on how much commercial paper a commercial bank can hold, one begins to understand why commercial bankers are puzzled by the arguments advanced about the "risks" of commercial paper for commercial banks. *See* footnotes 43-44 at page 24, *infra*.

This treatment of commercial paper as a loan is consistent with the historical development of the instrument. The commercial paper market in the United States developed rapidly after the Civil War as a result of a great expansion in industry and trade, to a total outstanding volume of $2 billion in 1914.[33] By 1920, however, the market began to decline and there was a parallel decline in direct loans by banks to commercial and

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[32] *See* Stigum, *supra* note 10, at 632.

[33] *See* Greef, *supra* note 8, at 38, 115.

industrial customers.[34] The outstandings of commercial paper and bank loans moved in parallel because they were essentially two equivalent methods for business to obtain bank credit.[35]

The decline in commercial loans and in commercial paper, its functional equivalent, was "brought about by similar forces," principally the dramatic increase in corporate underwritings.[36] In the 1920s "underwritings had steadily increased as money conditions became easier, making it possible to obtain capital in the form of long term or capital securities at a decreasing rate of interest or cost"; from 1919 to 1929 annual underwritings of corporate securities jumped from approximately $2.7 billion to $10.3 billion.[37]

The decline in commercial loans and commercial paper encouraged banks to seek employment in the securities markets for increasing amounts of surplus funds. As a result the banks became heavily involved in securities activities.

Congress was greatly alarmed by this flow of bank funds away from commercial loans and commercial paper:

> The flow of funds through the hands of the general public into those of the corporations, and from the latter into the hands of brokers and dealers, who then re-lent the funds to the public engaged in speculation, was thus primarily the result of a loose banking policy which had turned from the making of loans on commercial paper to the making of loans on security.[38]

Accordingly Congress enacted Glass-Steagall to restrict the securities activities of banks and to encourage the flow of bank funds back to commercial loans and commercial paper.

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[34] *Id.* at 177; *Operation of the National and Federal Reserve Banking Systems: Hearings Before the Senate Comm. on Banking and Currency ("1932 Hearings")*, 72d Cong., 1st Sess. 271, 299-300 (1932).

[35] *See* Foulke, *supra* note 15, at 146-47.

[36] *See* Greef, *supra* note 8, at 177.

[37] *See* Foulke, *supra* note 15, at 19-20.

[38] S. Rep. No. 77, 73d Cong., 1st Sess. 4 (1933).

The impetus for Glass-Steagall and its entire legislative history therefore demonstrate that Congress distinguished between commercial paper and "securities." For example a manager of the bill that became Glass-Steagall noted the growth in corporate borrowing "by the sale of their own securities rather than by borrowing at the commercial banks upon their commercial paper—that is, upon their notes."[39] By the term "securities" Congress meant only instruments representing "long-term" investments that "tied up" bank funds and thus could threaten bank solvency.[40] Congress was not concerned with instruments that historically had functioned as short-term commercial credit instruments.[41]

The fact that Senator Glass argued for an exclusion of commercial paper from the definition of securities in the almost contemporaneous Securities Act of 1933 but did not create a specific exemption in his own namesake does not make commercial paper a security in the eyes of the 73d Congress.

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[39] 75 Cong. Rec. 9904 (1932) (remarks of Senator Walcott).

[40] S. Rep. No. 77, 73d Cong., 1st Sess. 8 (1933). In 1929 and subsequent years when securities such as stocks and bonds became virtually worthless, outstanding commercial paper was paid regularly. *See* Greef, *supra* note 8, at 182-83. In the decade prior to Glass-Steagall bank losses on commercial paper were significantly less than even losses on direct bank loans and discounts, in addition to being a mere fraction of bank losses on stocks and bonds. *See* Foulke, *supra* note 15, at 84-89.

[41] SIA argues that in discussing the commercial paper activities of banks Congress referred only to their "purchasing commercial paper for their own accounts" because banks had not sold commercial paper. SIA Br. 20. In fact commercial banks had sold as well as purchased commercial paper. *See* Greef, *supra* note 8, at 379. As confirmed by Goldman Sachs, big city banks purchased commercial paper "either directly from the issuers or indirectly through commercial paper houses and placed portions of the paper, or 'participations,' with other institutions." Goldman Sachs Br. 25-26.

Rather it shows they recognized that his bill did not include such paper within the meaning of "securities."[42]

In summary, commercial paper is the functional equivalent of a commercial loan. A purchaser of commercial paper advances money to the issuer of the paper in return for the issuer's promise to pay back the money advanced on a specific future date, with interest either discounted or at a stated rate. Commercial banks have long been integrally involved in the commercial paper market, by purchasing paper for their own account, by extending back-up lines of credit to the issuers of the paper, and by selling paper to correspondent banks and other customers. There is no reason to change a commercial bank's historical function simply because it chooses to increase the amount of its activity.

III.

Commercial Paper Does Not Have The Market Risk Inherent In Securities.

Commercial banking is not risk free. In extending a loan there is always the possibility of a default, and when a bank purchases commercial paper or extends a back-up line of credit to the issuer to support its paper there is the credit risk that the paper may not be paid at maturity.

Thus banks have assumed and will continue to assume the credit risk involved with commercial paper. That risk, however, is neither greater than nor different from the ordinary lending risk that banks traditionally have undertaken. Indeed,

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[42] Senator Glass' proposed amendment to exclude commercial paper from the definition of a "security" in the Securities Act was eventually adopted by Congress as an exemption from the registration requirements of that Act and his statements concerning the need for such an amendment demonstrate that he viewed commercial paper activities as closely linked to commercial banking and not as a speculative investment banking activity that the Glass-Steagall Act was intended to prohibit. *See* J.A. 133A-134A (Statement of the Board); *Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 98 (1933) (remarks of Senator Glass).

the potential risk involved with commercial paper is significantly less than with a typical cross section of commercial bank loans because the default rate on commercial paper is only a fraction of that on other commercial bank loans.[43]

In addition, commercial paper does not carry significant market risk.[44] Commercial paper "does not fluctuate with

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[43] *See* Greef, *supra* note 8, at 182-83.

Commercial paper defaults over the past 15 years, including Penn Central, average approximately 1/100 of 1 percent of average annual commercial paper outstanding. *See* Stigum, *supra* note 10, at 628, 635. By comparison, average net loan losses for 1982 of the 10 largest bank holding companies exceeded 50/100 of 1 percent of average loans outstanding. *See* Morgan Stanley Investment Research, *Bank Performance Review 1983 Edition* 164-65. Thus the risk of commercial bank loan loss was approximately 50 times greater than that of commercial paper default.

The money market judges commercial paper to be among the most riskless of all instruments as evidenced by the fact that the rates paid on commercial paper are only slightly above those paid on Treasury bills themselves. *See* Hurley, *supra* note 11, at 525.

[44] Full value of commercial paper can be realized by waiting the relatively short period until maturity. The average maturity is less than 30 days and less than 1½ percent is sold before maturity. *See* Stigum, *supra* note 10, at 632, 641.

Another indication of the relative risklessness of commercial paper is its treatment under the "net capital" rules of the SEC. In calculating the "net capital" of a broker-dealer, SEC regulations, 17 C.F.R. § 240.15c3-1(c)(2)(vi)(1983), provide that certain specified percentages shall be deducted from "the market value of all securities, money market instruments or options in the proprietary or other accounts of the broker or dealer." Subdivision (E) thereof, entitled "Commercial paper, bankers acceptances and certificates of deposit," provides that any highly rated short-term promissory note with a maturity not exceeding nine months shall have "0 percent" deducted if the note has less than 30 days to maturity, and ¾ of 1 percent if the note has 181 days but less than 271 days to maturity. For comparison, Subdivision (F) thereof provides that a highly rated fixed rate debt security with a maturity of less than one year shall be subject to a deduction of two percent, and nine percent for a five year obligation.

general business conditions . . . or speculative activity on the stock market."[45] As so vividly put by Senator Glass,

> a man who makes a loan on commercial paper does not have to stand at a ticker and find out what is going to be the value of it 15 minutes afterwards.[46]

That is the difference between commercial paper and a security.

As with any commercial loan, commercial paper can lose its value if the issuer turns out to be a poor credit risk. But that is a credit risk, not a market risk, and securities are subject to both. Commercial paper is essentially subject only to the credit risk.[47]

Petitioners and their *amici* (*e.g.*, Becker Supplemental Appendix) have attempted to cast doubt on what commercial paper really is, *i.e.*, a short-term promissory note. Goldman Sachs even went so far as to argue (Br. 17-21) that commercial paper is a long-term instrument. Why would they make so desperate an argument? Because they recognize without saying it that they have to convert commercial paper into some-

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[45] *See* Foulke, *supra* note 15, at 92 (1933).

[46] *See* 1932 Hearings, *supra* note 34, at 267.

[47] Goldman Sachs cites the Penn Central case as evidence of the risk in commercial paper. But Penn Central evidences a credit risk, not a market risk. In fact Penn Central does not so much evidence the riskiness of commercial paper as it does a breakdown in the corporate disclosure system. *See University Hill Foundation* v. *Goldman, Sachs & Co.*, 422 F. Supp. 879 (S.D.N.Y. 1976). Since then commercial paper has come to be rated on a widespread basis by five independent rating services. Consequently, unrated or lower-rated paper cannot be sold easily in today's market. *See* Abken, *supra* note 10, at 15; Hurley, *supra* note 11, at 528-29. Bankers Trust does not handle unrated or low-rated paper. Moreover, the "hazard" of Bankers Trust's potential liability under Section 12(2) of the Securities Act of 1933 (Goldman Sachs Br. 11) for selling commercial paper is at most conjectural and the Court should not be asked to assume that Bankers Trust is handling its issuers' commercial paper in the manner that Goldman Sachs handled Penn Central paper.

thing that has a significant market risk if they hope to argue successfully that it is a security.

Their argument falls of its own weight. The financial markets are not confused. The *Encyclopedia of Banking and Finance* defines commercial paper as "[a]ll classes of short-term negotiable instruments (notes, bills, and acceptances) that arise out of commercial, as distinguished from speculative, investment, real estate, personal, or public transactions; . . . ."[48] The Board was not confused. The court of appeals was not confused. In fact, the court of appeals effectively stripped away the desperate arguments made by petitioners by narrowly limiting its decision to commercial paper exempted by Section 3(a)(3) from registration under the Securities Act of 1933.

Thus the court of appeals wisely reserved for another case and another day the possibility that someone would attempt to apply the term "commercial paper" to an instrument with market risk. The court of appeals dealt with commercial paper as it is today, the quintessential short-term note that is indistinguishable from a traditional bank loan.

IV.

Bankers Trust's Commercial Paper Service Does Not Expose The Bank To Hazards That Glass-Steagall Sought To Avoid.

In addition to the relative risklessness of commercial paper as discussed above, two factors are of paramount importance in considering the questions raised by petitioners concerning the "hazards" that Glass-Steagall sought to avoid. Both factors arise from the short-term nature of commercial paper. First, sophisticated purchasers are buying commercial paper to earn interest while they are waiting to invest their funds. Second, when the purchaser wants its funds it merely presents the paper at maturity. Consequently commercial paper is neither an investment in the traditional sense nor an investment giving rise to the "hazards" discussed by this Court in *ICI I*.

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[48] Munn and Garcia, *supra* note 31, at 196.

That case dealt with undivided participation interests in a pool of common stock being sold to the general public. The dangers for banks which the Court identified in that situation are not present in Bankers Trust's commercial paper activities. In *ICI I* the Court was dealing with long-term investments, but here we are dealing with short-term borrowing, which is the basic business of commercial banks. There is no danger of bank assets' being invested in frozen or otherwise imprudent stock or long-term security investments.

The "subtle hazards" described in *ICI I* are similarly inapplicable to Bankers Trust's commercial paper activities. One hazard was that a bank might make unsound loans to companies. But even if Bankers Trust were to purchase and keep commercial paper, it would do so under existing loan powers and within existing lending limits.[49] *See* page 20, *supra*.

Another hazard identified in *ICI I* was that a bank would make unsound loans to individual investors to enable them to purchase securities. This hazard has little relevance to commercial paper sales because the purchasers are mainly financial institutions and corporations that do not borrow from banks in order to finance the acquisition of commercial paper because it is rarely profitable to do so.[50]

A third hazard mentioned was that bad judgment could erode the confidence of depositors and the public in the bank and thereby threaten the stability of the bank itself. This

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[49] Goldman Sachs contends that Bankers Trust assures the success of the issuance by taking up the paper itself, either by buying the paper back from the original purchaser if it has an unexpected need for cash, or by "parking" the paper with its parent holding company for subsequent resale. Goldman Sachs Br. 7. In fact, the record states that the bank's sales of commercial paper are not "subject to a repurchase agreement between [the bank] and the purchaser" (R.65) and the Guidelines prohibit bank sales of commercial paper it handles to a non-bank affiliate. *See* ¶ 8, J.A. 189A.

[50] Report from the Board's On-Site Investigation of Bankers Trust 4 (May 8, 1980) (R. 593) (no evidence that funds borrowed from Bankers Trust were used to purchase commercial paper for which the bank acted as agent).

hazard is not applicable where the bank is assisting a well known and highly rated issuer of commercial paper in transactions that are in effect limited placements of short-term, prime quality borrowings with sophisticated purchasers, rather than sales to the general public of participations in a commingled stock investment fund bearing the bank's name as in *ICI I*. In the commercial paper situation the purchasers immediately recognize the issuers and do not associate them with the bank.

Lastly, the hazard that a bank might not tender disinterested advice to the purchaser is not present. Bankers Trust does not advise the purchasers to purchase the commercial paper. They are all institutional purchasers or other sophisticated investors that make their own decisions on how to earn interest on excess funds for brief periods.

Petitioners and their *amici* argue that the "promotional" aspects of and the "salesman's stake" in selling commercial paper raise a special hazard.[51] Their argument raises for them the difficulty of distinguishing the effect of those same aspects of banks' dealing in loan participations, bankers' acceptances, and certificates of deposit. If banks are to be forbidden the right to deal in commercial paper because of the ability to earn a fee or a "spread" in connection with its sale, then that decision raises the same questions with respect to other traditional bank credit instruments. The risks are not different. Moreover one cannot have the consequences envisaged in connection with the "potential hazards" of promoting long-term securities when the purchaser is a sophisticated financial institution and

[51] Assuming a fee on the sale of commercial paper of 1/8 of 1 percent per annum (*see* Abken, *supra* note 10, at 11), the sale of $1,000,000 of 30-day paper would produce revenue of approximately $100. In comparison, underwriting notes, debentures or bonds has been producing for an investment banker a fee of $8,000 to $8,750 per $1,000,000 of debt sold, depending on whether the bonds are sold on competitive or negotiated offering. *See* D. Darst, *The Complete Bond Book* 239 (1975). (Bankers Trust believes that investment banking fees have decreased since 1975 and are currently in the range of $6,250 to $8,750 per $1,000,000 of the debt sold.)

all the purchaser has to do is wait an average of less than 30 days in order to receive full payment of principal and interest.

Goldman Sachs claims (Br. 10-11) that the very bank lines of credit that make commercial paper such a safe credit instrument create a conflict of interest when the commercial bank both handles the commercial paper and provides all or part of the back-up line of credit. Their argument misconstrues the commercial paper market. The institution handling commercial paper for the issuer cannot choose between continuing to sell the issuer's paper in the market and having the issuer draw on its lines of credit (as Goldman Sachs' argument presumes). The purchasers in the market are too sophisticated to buy if there is a question of creditworthiness. If a credit problem were to appear, purchasers would stop buying immediately, no matter what the institution did. Therefore, whether or not the lines are drawn upon is not a decision of the institution handling the paper; it is a decision of the marketplace.

Goldman Sachs also raises the potential liability of the institution handling an issuer's commercial paper if the issuer goes bankrupt while its paper is outstanding.[52] But this is not a new risk to banks. Banks have also been sued on loan participations for alleged non-disclosure under the securities laws, but that is not any reason to prohibit the sale of such instruments.

Petitioners and their *amici* also misuse the Board's Guidelines in an attempt to make a vice out of a regulatory virtue. As the court of appeals noted,[53] the Board was exercising its

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[52] In view of the safety of commercial paper, this is in any case a *de minimis* risk. *See* note 43, *supra*.

[53] "[T]he Board issued guidelines to ensure that sale of third party commercial paper did not give rise to 'unsafe or unsound practices.' These guidelines permitted banks to sell only prime quality third party commercial paper with maturity of nine months or less and in denominations of over $100,000. Banks could sell only to 'financially sophisticated customers,' and were forbidden to advertise to the general public. Sales to the bank's fiduciary accounts, parent holding companies and nonbank affiliates were also forbidden. Moreover, banks were required to maintain credit analyses of issuers, to limit

statutory powers to regulate "unsafe or unsound practices," not interpretative powers under Glass-Steagall as petitioners and their *amici* allege. There is a vast distinction. Even when instruments are universally conceded not to be securities for purposes of Glass-Steagall, *e.g.*, loan participations and bankers' acceptances, the banking regulators often regulate their use.[54] The issuance of the Guidelines was an exercise in proper bank supervision and the fact that the Board issued guidelines does not make the instrument a "security" for purposes of Glass-Steagall.

CONCLUSION

The court of appeals issued a very narrow decision upholding the Board's very narrow decision, both of which were limited to holding that commercial paper that is exempt under Section 3(a)(3) from registration under the Securities Act of 1933 is not a security for purposes of Glass-Steagall. The judgment of the court of appeals should be affirmed.

Respectfully submitted,

JOHN W. BARNUM
(Counsel of Record)
JENNIFER A. SULLIVAN
W. MICHAEL TUPMAN
WHITE & CASE
1747 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 872-0013
Attorneys for Bankers Trust Company as Amicus Curiae

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the amount of paper sold for any issuer, and to maintain detailed records of sales, purchases and lines of credit extended. Finally, various disclosure requirements were imposed." (J.A. 225A) (Footnote omitted.)

[54] *See* Comptroller of the Currency, Banking Circular BC-181, *Purchase or Sale of Loans in Whole or in Part—Participations* (Dec. 8, 1983) (concerning loan participations); 12 C.F.R. § 208.8(d) (1983) (concerning bankers' acceptances).

No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION, *et al.*,
Petitioners,

v.

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR GOLDMAN, SACHS & CO. AS AMICUS CURIAE IN SUPPORT OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

G. DUANE VIETH
LEONARD H. BECKER*
DANIEL I. PRYWES
PETER K. KAUTSKY

ARNOLD & PORTER
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

Attorneys for Amicus Curiae Goldman, Sachs & Co.

OF COUNSEL:

JOSEPH MCLAUGHLIN, ESQ.
VICE PRESIDENT-GENERAL COUNSEL
GOLDMAN, SACHS & CO.
85 Broad Street
New York, New York 10004
(212) 902-5732

**Counsel of Record*

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED FOR REVIEW

Did the court of appeals err in upholding the legal determination of the Board of Governors of the Federal Reserve System (the "Board") that a commercial bank may market third-party commercial paper to the institutional investing public without violating the Glass-Steagall Act?

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BRIEF FOR GOLDMAN, SACHS & CO. AS AMICUS CURIAE IN SUPPORT OF PETITIONER SECURITIES INDUSTRY ASSOCIATION

Goldman, Sachs & Co. ("Goldman Sachs") respectfully submits this brief as *amicus curiae* in support of petitioner Securities Industry Association (the "SIA").

INTEREST OF AMICUS CURIAE

Goldman, Sachs & Co. is a partnership engaged in the securities and investment banking business, part of which consists of acting as a dealer in commercial paper.[1] The firm, together with its predecessors, has been continuously and actively en-

[1] Since August 1983, Goldman Sachs has conducted its commercial paper business through a wholly-owned subsidiary corporation, Goldman Sachs Money Markets Inc. References to Goldman Sachs in this Brief include Goldman Sachs Money Markets Inc.

gaged in the marketing of commercial paper since 1869. The firm has extensive experience in the field of commercial paper placement. Goldman Sachs is, and for many years has been, the largest dealer in the United States in terms of the dollar volume of the outstanding commercial paper of its issuing clients.

Pursuant to leave granted by the courts below, Goldman Sachs filed briefs as *amicus curiae* in support of SIA. Goldman Sachs urges that the marketing of third-party commercial paper notes by Bankers Trust Company ("Bankers Trust" or the "Bank") to unaffiliated investors is an activity not engaged in by commercial banks in this country at least since the adoption of the Glass-Steagall Act in 1933, and constitutes a violation of that statute.[2] Goldman Sachs also urges that the Federal Reserve Board (the "Board") erred in its legal determination that Glass-Steagall has no application to the Bank's marketing activity on the theory that commercial paper does not constitute "notes" within the meaning of Glass-Steagall Section 21, 12 U.S.C. § 378. In pertinent part, that statute forbids deposit-taking institutions, such as Bankers Trust, to engage in the "business of issuing, underwriting, selling, or distributing . . . notes, or other securites."

SUMMARY OF ARGUMENT

Bankers Trust's marketing of commercial paper of third-party issuers to unaffiliated non-bank investors launches the commercial banking industry into uncharted and novel activities. Those activities expose the Bank to hazards that Glass-

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[2] Although this Brief makes numerous references to Bankers Trust in the course of developing its argument, Goldman Sachs does not mean to suggest that the Bank is less likely than other commercial banks to avoid the hazards described herein. The Federal Reserve Board's determination regarding Bankers Trust presumably applies to all commercial banks proposing to undertake similar activities, and Goldman Sachs argues that the Glass-Steagall Act was intended to insulate all commercial banks from such hazards.

Steagall was intended to prevent—*first*, by introducing a "salesman's stake" in the marketing of third-party commercial paper that threatens to disturb the Bank's disinterested analysis of the creditworthiness of commercial paper issuers; and *second*, as happened to Goldman Sachs in the Penn Central collapse, by exposing the Bank to legal claims from purchasers of the paper if the issuer defaults.

The Bank's conduct in regard to commercial paper constitutes a radical departure from traditional activities of commercial banks, which until now have *purchased* commercial paper as *lenders* to third-party issuers. Bankers Trust's new marketing role violates Glass-Steagall, because it amounts to the "underwriting, selling, or distributing [of] . . . notes, or other securities" in violation of Glass-Steagall Section 21.

ARGUMENT

I. THE MARKETING ACTIVITY OF BANKERS TRUST IS CONDUCT THAT IS FORBIDDEN BY GLASS-STEAGALL SECTION 21 AND THAT GIVES RISE TO HAZARDS CONGRESS MEANT TO FORESTALL

The court of appeals adopted the Board's "functional anaylsis" of the commercial paper at issue. *E.g.*, *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 693 F.2d 136, 147 (D.C. Cir. 1982) (J.A. 241).[3] The court might more properly have described the analysis as "non-functional." For the Board's approach entails consideration of commercial paper in the abstract, without regard to the nature of Bankers Trust's activity in marketing that paper to unaffiliated customers. *See id.* at 148 n.75 (J.A. 243). By failing to take as the centerpiece of analysis that Bankers Trust is *marketing* third-party paper, both the Board and the court of appeals overlooked key purposes of Glass-Steagall, and particularly its Section 21—notably, to shield the Bank's disinterested advice from the untoward influence that inevitably follows from its

[3] "J.A." refers to the Joint Appendix filed in this Court.

looking to the salesman's commission rather than the borrower's interest payments as the source of its profit on the transaction.

The objectives of the Glass-Steagall Act are well known. Following the banking crisis that beset the nation with the collapse of the securities markets in 1929, Congress determined to remove the commercial banking industry from virtually all aspects of the marketing of corporate instruments and to restrict the commercial banking system to its traditional functions—accepting deposits and making loans.[4] That basic policy decision was sound and should be enforced by the courts.

A. Glass-Steagall Bars Bankers Trust From "Underwriting, Selling, or Distributing" Commercial Paper

Glass-Steagall Section 21, 12 U.S.C. § 378, is a key provision of the statutory scheme, and is controlling here. In pertinent part, Section 21(a)(1) makes it unlawful for any institution engaged in the business of receiving demand deposits also to

> "*engage . . . in the business of* issuing, *underwriting, selling, or distributing*, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, *notes*, or other securities" (emphasis supplied).

The prohibition of Glass-Steagall Section 21 is plain and sweeping. The statute forbids any entity providing commercial banking services to market a wide variety of corporate instruments, including "notes." Violation is a criminal offense. As the district court correctly put it: "The statute draws broad lines, leaving no room for administrative amendment." *A. G. Becker Inc.* v. *Board of Governors of the Federal Reserve System*, 519 F. Supp. 602, 614 (D.D.C. 1981) (J.A. 214).

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[4] *See generally Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971) (Glass-Steagall a "drastic step" to keep commercial banks "from going into the investment banking business"); *Baker, Watts & Co.* v. *Saxon*, 261 F. Supp. 247, 249-50 (D.D.C. 1966) (Holtzoff, J.), *aff'd sub nom. Port of New York Authority* v. *Baker, Watts & Co.*, 129 U.S. App. D.C. 173, 392 F.2d 497 (D.C. Cir. 1968).

Under Glass-Steagall Section 21, Bankers Trust's handling of third-party commercial paper is unlawful if the activity constitutes "engag[ing] in the business" of any one or more of "underwriting, selling, or distributing," provided only that the paper marketed by the Bank is deemed "notes, or other securities" within the statute. This is the case without regard to whether the Bank's activity is "at wholesale or retail, or through syndicate participation."

Bankers Trust's activity plainly amounts to at least three of the four forbidden kinds of activity. Consequently, the activity is prohibited to Bankers Trust under Section 21 if (as we shall demonstrate in Part II of this Brief) the commercial paper constitutes "notes" or "other securities."

1. "Selling"

Bankers Trust undeniably is engaged in "selling" the commercial notes of third-party issuers. The Board conceded the point in the court of appeals. Brief for Appellant at 46. Moreover, the Bank's general counsel so advised the Board:

> "The activity consists of acting as financial advisor to and agent for an issuer of commercial paper. BTCo, acting as financial adviser to the issuer, checks the market for the issuer. BTCo then advises the issuer how much, at what rate and for what maturity it should sell commercial paper. *Then BTCo, acting as the issuer's agent, sells such commercial paper to those who are interested*" (J.A. 33) (emphasis supplied).

2. "Distributing"

Bankers Trust also has acknowledged that its commercial paper activities entail distribution. As the Bank states in its soliciting materials, it seeks "to expand sales *distribution,*" so as to put the commercial paper issuer "in contact with more segments of the market . . . [and] to increase demand for your commercial paper" (J.A. 40; *see* J.A. 43) (emphasis supplied).

3. "Underwriting"

The Bank also is engaged in "underwriting." Before the Board, Bankers Trust nominally disclaimed any responsibility to the commercial paper issuer to place the paper sought to be marketed through its facilities. But the Bank acknowledged that if all of the paper brought to market could not be sold on the date of proposed placement, the Bank might well advance an overnight loan to the issuer "using the unsold paper as collateral" (J.A. 37), or, putting it differently, "without prior commitment, [the Bank might] lend short term funds [to the issuer] at or near the commercial paper rate . . ., taking back notes . . . as evidence of indebtedness" (J.A. 54).

The Bank also acknowledged that on behalf of its parent holding company, the Bank was making purchases "in the secondary market [of commercial paper] of issuers for which it acts as agent and financial advisor" (J.A. 55). Presumably this referred to "buy-back" transactions effected by the Bank where the original purchaser of the paper had an unexpected need for cash.

While the SIA and A. G. Becker petitions were pending before the Board, a member of the Board's legal staff advised the Governors that there was reason to question the Bank's assertion that its activities fell outside the strictures of Glass-Steagall:

> "That's what they say but there are two modifying conditions. First of all, they told us that the parent holding company does purchase paper that the bank is selling for the holding companies *[sic]* own account. Now we haven't been able to connect that up to show that it's like an underwriting. The holding company may be holding it as a permanent investment *but they said it's possible that the holding company may have sold the paper out of the holding company's portfolio which makes it look sort of like an underwriting.* The other thing that qualifies it is *Bankers Trust will make a loan at the commercial paper rate for a portion of the unsold proceeds of the paper that the bank is trying to sell*" (J.A. 111) (emphasis supplied).

In other words, it appeared that the Bank was undertaking to its commercial paper issuers that it would take up unsold paper itself, and that the Bank might temporarily "park" paper with its holding company parent for subsequent resale if necessary to assure the success of the offering. The Board subsequently confirmed this understanding of the Bank's activities (J.A. 123), which we submit amount to "underwriting" activities in the placement of paper.

In sum, Bankers Trust actively seeks out purchasers for the commercial paper offered by the third-party issuer. The Bank protects the issuer in the event the paper cannot be fully placed on the day of offer (J.A. 37, 54). And the Bank apparently is "parking" paper for subsequent resale with its holding company parent (J.A. 111).

The tentative phrasing of Bankers Trust's representations concerning the actions it might take if it is unable to sell out an issuer's commercial paper should be viewed with skepticism. Bankers Trust is competing with other firms, such as Goldman Sachs, that market commercial paper. Competitive pressures will lead Bankers Trust to purchase unsold commercial paper in situations where investment banking firms would do so.

Such activities qualify the Bank's activities as an underwriting. In effect, the Bank offers the issuers reasonable assurances, either tacit or explicit, that either the Bank itself or its holding company parent will meet the funding needs of the would-be borrower. In such circumstances, the status of the transaction as an underwriting, and of the bank as an underwriter, cannot seriously be disputed.[5]

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[5] As one district court concluded in a case involving Goldman Sachs: "There can be no serious question that in buying virtually all of the paper issued by . . . [the issuer], distributing it to investors and taking the unsold portions into its inventory, [Goldman Sachs] functioned as an underwriter both as that term is defined in the Securities Act [of 1933] and as commonly understood in the American financial community." *University Hill Foundation* v. *Goldman, Sachs & Co.*, 422 F. Supp. 879, 900 (S.D.N.Y. 1976) (footnotes omitted).

An independent basis for treating a commercial paper dealer as an "underwriter" under Glass-Steagall Section 21 arises from the reliance that commercial paper investors place — at least to a significant degree — on the dealer's reputation in making their investment decisions. In a case in which holders of defaulted paper sued a dealer, Judge Stevens (as he then was) said:

> "The relationship between the underwriter and its customers implicitly involves a favorable recommendation of the issued security. Because the public relies on the integrity, independence and expertise of the underwriter, the underwriter's participation significantly enhances the marketability of the security." *Sanders* v. *John Nuveen & Co.*, 524 F.2d 1064, 1070 (7th Cir. 1975) (footnotes omitted), *vacated and remanded on other grounds*, 425 U.S. 929 (1976).

The degree of sponsorship of an issuer that is implicit in a commercial paper dealer's marketing role confirms that a dealer should be deemed an "underwriter" for purposes of Glass-Steagall.[6]

B. Bankers Trust's Marketing Of Third-Party Commercial Paper Poses Hazards Sought To Be Eliminated By Glass-Steagall

Bankers Trust's marketing of third-party commercial paper gives rise to hazards of the kind that Congress sought to remove from the commercial banking sector when it enacted Glass-Steagall—hazards not adverted to in the court of appeals' opinion, but nonetheless real. Because the briefs of petitioners SIA and A. G. Becker will deal extensively with this issue, Goldman Sachs will limit this aspect of its discussion to two concerns that are particularly pertinent to its experience as a commercial paper dealer.

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[6] Goldman Sachs does not necessarily agree with the scope of investigatory duties imposed by the Seventh Circuit in *Sanders* upon the commercial paper dealer for purposes of securities act liabilities. *Compare University Hill Foundation, supra*, 422 F. Supp. at 899-901.

1. Bankers Trust Necessarily Has a "Salesman's Stake" in the Transaction

In *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971) *("ICI I")*, this Court concluded that Congress had

> "acted to keep commercial banks out of the investment banking business largely because it believed that the promotional incentives of investment banking and the investment banker's pecuniary stake in the success of particular investment opportunities was destructive of prudent and disinterested commercial banking and of public confidence in the commercial banking system." 401 U.S. at 634.

These concerns recently have been echoed by E. G. Corrigan, President of the Federal Reserve Bank of Minneapolis, who has commented that two of the essential functions of banks depend upon the avoidance of such hazards. Corrigan, *What is a Bank Under the Holding Company Act?*, Am. Banker, March 31, 1983, at 11. *First*, the role of banks as issuers of "transaction accounts" gives rise to concerns about strains on bank liquidity and sudden drains on commercial bank demand deposits—dangers that can be avoided only by preserving public confidence in banks' capacity to meet their deposit obligations. "The evidence is overwhelming . . . that most 'problem' bank situations in recent years involved concerns growing out of losses or perceived losses associated with lending, securities activities, foreign exchange activities and/or poor management." *Id.* at 23.

Second, commercial banks occupy a critical role as "the primary source of liquidity for all other classes and sizes of institutions, both financial and nonfinancial." *Id.* at 23. The ability of a bank to fulfill this role depends on its ready access to deposit and nondeposit sources of funding. These in turn depend on market judgments concerning, among other things, "the quality and consistency of credit judgments made by banks." *Id.* at 24. Particularly in periods of stress, "banks must be in a position to make rigorous, impartial, and objective credit decisions, because it is precisely in such circumstances that the potential for compromise in the impartiality of the

credit decision making process is greatest and the potential for asset quality deterioration is the largest." *Id.* at 24.

A bank acting as commercial paper dealer subjects itself to the stresses and hazards described above. Bankers Trust, for example, is no longer extending a loan to a borrower on the strength of the issuer's paper; it is promoting the paper to unrelated investors, to induce *them* to take up the paper. The former class of transaction is the traditional lending function of the bank, in which it looks to the interest (or discount) for its return. In the latter class of transaction, the bank bases its return on the commissions associated with its salesman's stake, with a concomitant impact on the bank's disinterested analysis of the creditworthiness of the issuer. The district court stated the point cogently:

> "The problem with the Board's analysis [is that] it ignores the specific conduct of the bank, glossing over whether the bank purchases commercial paper for its own account . . . or purchases for future sale to an outside party or arranges a transaction between purchaser and seller. . . . One factor present in this matter compels the conclusion that the commercial paper at issue here is not a loan, and *that crucial aspect is the role of Bankers Trust in the transactions.*" 519 F. Supp. at 615-16 (J.A. 217) (emphasis supplied) (footnote omitted).

In dealing with a commercial paper issuer, a bank acting as dealer is subject to a continuing tension between (i) protecting the bank's customers who have purchased the issuer's commercial paper, and (ii) protecting the bank's own line of credit facility. Take the case of an issuer that has availed itself of the bank's commercial paper marketing services, has opened a line of credit facility with the bank, and subsequently experiences financial distress. The bank now faces a dilemma. If it refuses to assist the issuer in rolling over its outstandings, or in marketing new paper, it exposes its funds if the issuer draws on its line of credit in order to pay the paper as it matures. If the bank decides to continue to market the paper, it opens itself to the charge that it did so to protect its own position. In either case, the credit judgment may be perfectly appropriate given

the issuer's particular circumstances, but it can hardly be deemed disinterested, impartial, or objective as intended by Congress in Glass-Steagall.

A non-bank commercial paper dealer does not confront such a dilemma. Commercial paper issuers are required in nearly all instances to arrange back-up bank lines of credit equal in amount to 100 percent of the face value of the commercial paper to be marketed. That is, the issuer must arrange for a commercial bank to provide stand-by lending authority sufficient to cover the full amount of the commercial paper when it comes due. The non-bank dealer is not responsible for the bank line of credit. Thus, it can require the issuer to resort to the line of credit solely on the merits of the issuer's creditworthiness.

The Board's "guidelines" regulating commercial bank marketing of commercial paper do not deal with the potential conflict arising from the Bank's dual role as dealer and back-up lender, other than to restrict the selling bank's participation in supporting lines of credit up to the amount of its legal lending limit. 46 Fed. Reg. 29,333-34 (1981). Nor did the court of appeals below consider this potential hazard.

2. The Marketer Makes Implied Representations Regarding the Creditworthiness of the Issuer

As a matter of law, Bankers Trust's marketing of third-pary commercial paper carries the Bank's implied representation under Section 12(2) of the 1933 Securities Act, 15 U.S.C. § 77l(2), that in its opinion the issuer is creditworthy, and that that opinion has a reasonable basis—that is, that a reasonable credit investigation has been conducted. For breach of the implied representations, the Bank may be held liable, just like a commercial paper house, in a private action brought by a purchaser of the paper. *E.g.*, *University Hill Foundation* v. *Goldman, Sachs & Co.*, *supra*. That risk of liability places an additional burden on the business of commercial banking that Congress in 1933 determined commercial banks should not bear.

Contrary to the court of appeals' professions of confidence, based on low default rates, short maturities, and large denominations (*see* 693 F.2d at 148-49; J.A. 244-46), it cannot be assumed that the modern commercial paper market is free of risk even to the knowledgeable, sophisticated investor. As Judge Robb noted in dissent below (693 F.2d at 153-54; J.A. 253-55), Goldman Sachs unfortunately had occasion to learn as much in connection with the demise of Penn Central. *See University Hill Foundation*, *supra*, and related cases. The liability of marketers attendant upon the bankruptcy of corporate issuers was one of the burdens that Congress intended in Glass-Steagall to lift from the commercial banking industry.

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The Bank's exposure to risks of conflict of interest and increased potential liability for the financial distress of third-parties cannot be dismissed as speculative or remote possibilities beyond the ken of Congress. To the contrary, the remarks of Senator Bulkley, one of the principal supporters of the Glass-Steagall legislation, demonstrate that such concerns were uppermost in the mind of the enacting Congress:

> "Obviously, the banker who has nothing to sell to his depositors is much better qualified to advise disinterestedly and to regard diligently the safety of depositors than the banker who uses the list of depositors in his savings department to distribute circulars concerning the advantages of this, that, or the other investment on which the bank is to receive an originating profit or an underwriting profit or a distribution profit or a trading profit or any combination of such profits." 75 Cong. Rec. 9912 (1932), *discussed approvingly in ICI I*, *supra*, 401 U.S. at 633.

Congress had before it potential risks of the sort involved here when it enacted Glass-Steagall. It determined that rather than permit the Board to embark on a case-by-case analysis of the risks presented in particular circumstances, Congress would remove commercial banks by legislation from *any* exposure to those risks. That decision was implemented by means of plainly written, straightforward statutory prohibitions.

Congress has not acted to relax these prohibitions, nor is there any reason in policy to relax them. As one highly respected bank regulator has observed:

> "The case for segregating essential banking functions into an identifiable class of institutions is every bit as powerful today as it was in the 1930s. If anything, concerns regarding financial concentration, conflicts of interest, and the fiduciary responsibilities associated with lending depositors' money may be more relevant today than they were 50 years ago." Corrigan, *What Is a Bank Under the Holding Company Act?*, *supra*, at 25.

II. THE COMMERCIAL PAPER MARKETED BY BANKERS TRUST IS A "NOTE" WITHIN GLASS-STEAGALL SECTION 21

A. The "Notes" In Section 21 Cannot Properly Be Limited to "Investment Notes"

The term "notes" is not defined in Glass-Steagall—a fact that by itself suggests the word was meant to have its conventional meaning. This Court has admonished that the language of the statute is not to be given a narrow reading. *ICI I*, *supra*, 401 U.S. at 635. The Board forthrightly acknowledged in its statement of legal position issued in this proceeding that "the words in statutes should generally be interpreted in light of their ordinary meaning" (J.A. 131) (footnote omitted). Bankers Trust candidly advised the court of appeals that "commercial paper generally is defined as a kind of note" (Brief for Bankers Trust Company as *Amicus Curiae*, at 8). The district court concluded after careful analysis that the commercial paper marketed by Bankers Trust is a "note." 519 F. Supp. at 612-13 (J.A. 211-12). Even the court of appeals acknowledged in one point of its analysis that

> "the term 'notes' is sometimes used generically to refer to *any* promissory instrument, regardless of maturity or negotiability. In this sense, commercial paper may also be referred to as a promissory 'note.' " 693 F.2d at 143 (J.A. 234) (emphasis in original) (footnote omitted).

Nonetheless, the court of appeals concluded that the "notes" which are the subject of Glass-Steagall Section 21 do in-

clude all "notes," but only a subspecies called "investment notes." That conclusion was erroneous.

1. The Distinction Between "Notes" and "Investment Notes" is Unsupported in the Statute, Its Legislative History, and the Precedents

a. The Statutory Language

The text of Glass-Steagall Section 21 does not make the distinction between "notes" and "investment notes" advanced by the court below. The Section refers only—and pointedly—to "notes," as one of several categories of corporate instruments that commercial banks are forbidden to issue, sell, distribute, or underwrite. "Notes" are joined in the statutory prohibition by other forms of corporate instruments—"stocks, bonds, debentures," and "other securities." Like bonds and debentures, but unlike stocks, notes are promises to pay stated amounts at stated times. If, as the court of appeals thought, "notes" in Section 21 are to be known by the company they keep, 693 F.2d at 143 (J.A. 235), that company is mixed indeed. It includes written evidences of both straightforward promises to pay (bonds, debentures) and equity interests that may or may not promise to pay anything (stocks, other securities).

If Section 21 applied only to bonds, debentures, and notes, the court below could not plausibly have reasoned that the term "notes" means only some notes; plainly the term would refer to any promise to pay. But Section 21 applies more broadly. It includes stocks and other securities as well as notes, bonds, and debentures. From this circumstance it hardly follows that the term "notes" must mean something less than it otherwise would.

The court of appeals pointed to the supposedly short-term character of "notes" as contrasted to the long-term character of the other instruments covered by Section 21. *Id.* (J.A. 234). But Section 21 is not limited to "long-term" notes. If Congress had wished to restrict the Section in such a fashion, it knew how to do so. In Section 3(a)(3) of the 1933 Securities Act, passed only three weeks earlier, Congress exempted from the

registration requirement "any note . . . which [among other things] has a maturity at the time of issuance of not exceeding nine months . . . ." 48 Stat. 76. Congress drew no such line when it adopted Glass-Steagall Section 21.[7]

b. The Legislative History

The court of appeals found support for its distinction between "investment" and "commercial" notes in the legislative history of Glass-Steagall, 693 F.2d at 144-45 (J.A. 236-37), even as it professed surprise that "Congress nowhere considered the banks' activity in the commercial paper market as contributing to their difficulties." *Id.* at 145 (J.A. 236) (footnote omitted). The paucity of legislative material is not attributable to a congressional design that commercial banks should be left free to handle commercial paper in whatever manner they see fit. It is explained, rather, by the contemporaneous economic reality, recognized elsewhere by the court below, that "almost all commercial paper issued was purchased by commercial banks for their own account," 693 F.2d at 145 n.50 (J.A. 236), and that at the time Glass-Steagall was enacted, banks "purchased the vast bulk of instruments sold through the commercial paper market." *Id.* at 150 n.85 (J.A. 246). In other words, at the time Glass-Steagall was enacted, commercial paper was handled by commercial banks as conventional *lenders*, extending credit for their own account to commercial paper issuers as bank borrowers.

Thus, it is not surprising that what little pertinent legislative material there is uniformly reflects the Congressional intent that commercial banks should remove themselves from the activities of distributing and selling, and should revert to their traditional role as lenders. The Senate report that accompanied the Glass bill criticized the "loose banking policy" that

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[7] The 1933 Securities Act is instructive in another regard. There Congress qualified its definitional sections by the prefatory phrase "unless the context otherwise requires." 15 U.S.C. § 77b. Congress made no such definitional proviso in Glass-Steagall.

had departed from "the making of *loans* on commercial paper." S. Rep. No. 77, 73d Cong., 1st Sess. 4 (1933) (emphasis supplied). Senator Walcott, a floor manager of the Glass bill, expressed concern that corporations had ceased to finance their requirements "by *borrowing at the commercial banks* upon their commercial paper—that is, *upon their notes.*" 75 Cong. Rec. 9904 (1932) (emphasis supplied). Significantly, this Senator not only equated "commercial paper" with "notes," but regarded the commercial banks' proper role in the handling of commercial paper to be that of lenders to the issuers, *i.e.*, purchasers of the paper for the banks' own account.

An important indication of contemporaneous legislative intent, overlooked by the court below, may be found in a series of amendments to Glass-Steagall considered by Congress in 1935, two years after the enactment of the statute. One of the proposed amendments would have revised Glass-Steagall Section 16 (now codified as 12 U.S.C. § 24, Paragraph Seventh) to permit national and state member banks to "*underwrite* and *sell* bonds, debentures, and *notes.*" H.R. 7617, 74th Cong., 1st Sess. § 308(a), 79 Cong. Rec. 11,927 (1935) (emphasis supplied).[8] The proposed amendment would have imposed comprehensive restrictions on the permitted underwritings and sales activities, and would have subjected those activities to additional limits to be prescribed by the Comptroller of the Currency. Significantly, the proposed amendment would *not* have conferred comparable authority upon banks to underwrite and sell "stocks . . . or other securities"; as to these, the general prohibitions of Sections 16 and 21 would have remained. Despite the limited reach of the proposed amendment, and its elaborate structure of restrictions and regulations, the proposed amendment was stricken in conference. *See* H.R. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935). Congress thus rejected an amendment that would have permitted precisely

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[8] The proposed amendment is discussed in S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935), and quoted in 79 Cong. Rec. 11,927 (1935). The provisions of Section 16 apply to state-chartered institutions such as Bankers Trust by virtue of Section 5(c), Paragraph Fifth, of the Banking Act of 1933, 12 U.S.C. § 335.

the activity—the underwriting and selling of notes—on which Bankers Trust has embarked here.

c. The Precedents

The court of appeals pointed to no judicial precedent at all, nor to any pertinent prior Board ruling, to support its limitation of "notes" in Glass-Steagall to "investment notes." A 1973 interpretive ruling of the Board points up the difficulties with the court's reasoning. In 12 C.F.R. § 250.221, the Board disallowed a bank holding company's proposal to market "thrift notes" for financing non-bank operations, in part because of "the abuses that gave rise to the passage" of Glass-Steagall. Although the Board purported to distinguish "commercial paper" on the basis of its larger denomination and restricted sales to knowledgeable purchasers, neither of those distinctions can be found in Glass-Steagall.

2. The Supposed Distinction Between "Investment Notes" and "Commercial Notes" Does Not Exist in the Real World

The court of appeals thought that commercial paper "differs sharply" from "investment" notes; the former, it said, are used to raise short-term operating funds, while the latter are employed only for longer-term capital commitments. 693 F.2d at 143 (J.A. 243). This is incorrect. The asserted economic distinction between short-term credit and long-term capital finance was blurred even during the period antedating Glass-Steagall. As described by one authority:

> "The actual uses to which businesses put the advances [represented by notes] were significantly different from those sanctioned by 'classical' theory. *Short-term bank credit was used to a large extent for meeting enduring needs for working capital or for financing the acquisition of fixed assets*, as well as for meeting temporary bulges in current assets. . . . Commercial loans would never have become an important asset of the American banking system had they been limited to genuine self-liquidating advances.

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> "At the beginning of the present century an obvious schism between theory and practice existed in bank credit relationships with businesss enterprises. Short-term credit forms were used in connection with the advance of funds performing long-term functions in borrowing concerns." N. Jacoby & R. Saulnier, *Business Finance and Banking* 132, 138 (1947) (emphasis supplied).

This blurring of theory in practice has carried over to current times. Commercial paper today plays an important role in the overall financing operations of corporate enterprises. In an era of persistent inflation and high interest rates, capital finance markets, particularly the bond and debenture markets, are subjected to severe strains. In these circumstances:

> "Commercial paper financing by non-financial corporations has become less relied upon for cyclical contingencies and more relied upon as a steady source of short-term funds. . . . [T]he nature of debt as a whole has shifted to the shorter term due to widespread expectations of sustained, high inflation rates. These expectations have made short-term debt more prevalent in corporate financial plans, whereas at one time heavy short-term debt requirements were usually unexpected and temporary." *Commercial Paper—Growth Despite Severe Economic Swing*, Moody's Bond Survey, Nov. 24, 1980, at 238-39.

Would-be issuers of "stocks, bonds, debentures, . . . or other securities" regularly resort to the commercial paper market to satisfy their capital needs. As one current observer puts it: "The recent rapid growth in the commercial paper market owes much to the secular substitution of short-term for long-term debt, which accelerated because of the high rate of inflation in the late 1970s." Abken, *Commercial Paper*, Fed. Res. Bank of Richmond Econ. Rev., Mar.-Apr. 1981, at 11, 16.

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[9] Authorities writing prior to the enactment of Glass-Steagall observed that from the viewpoint of the borrower, notes are ready substitutes for bonds in the capital market when conditions warrant recourse to them. F. Mead, *Corporation Finance* 301 (1919 ed.). Another commentator classified "short-term notes" along with bonds, stocks, and shares as "investment credit instruments." H. Moulton, *The Financial Organization of Society* 107 (1925).

Thus, current market experience affords no basis to treat the instruments enumerated in Glass-Steagall Section 21 as if they differ fundamentally from one another—they are all available as capital-raising mechanisms.[10]

Increasingly, modern corporations have come to look upon commercial paper as a necessary adjunct—and in some cases a primary vehicle—to generate capital. Considerably more than half of the entire short-term debt of finance companies is comprised of commercial paper. Hurley, *The Commercial Paper Market*, 63 Fed. Res. Bull. 525, 526 (1977). Moreover, commercial paper has become "an important source of financing for large, well-known firms . . . ." *Id.* at 532.

Goldman Sachs' experience as a commercial paper dealer lends support to the conclusion that issuers frequently look to commercial paper as a substitute for long-term credit, not merely as a funding vehicle to meet temporary or cyclical needs. Many of Goldman Sachs' issuers have sold and continually "rolled over" commercial paper on a daily basis for years, even when such funds might have been raised through conventional long-term borrowing by bond or debenture offerings. The volume of commercial paper placed by Goldman Sachs increases substantially during periods of high long-term interest rates, as was the case throughout much of 1982. From the mid-1970's to the early 1980's, commercial paper outstandings trebled. Hurley, *The Commercial Paper Market Since the Mid-Seventies*, 68 Fed. Res. Bull. 327, 329 (1982). Goldman Sachs' data indicate that for its 10 largest U.S. industrial corporate issuers of commercial paper, the year-end average

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[10] In addition, the availability of revolving lines of credit that establish backing for paper issued over long periods of time, typically several years (*see* Abken, *supra*, at 12), enables corporate issuers to classify their commercial paper as long-term obligations. Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 6—Classification of Short-Term Obligations Expected to be Refinanced* (1975).

volume of such paper as a percentage of total corporate capital likewise trebled from 1975 to 1980.[11]

Finally, as is evidenced in recent no-action letters issued by the staff of the Securities and Exchange Commission, corporations have issued commercial paper to finance the acquisition or carrying of a broad range of financial assets such as consumer loans, retail installment paper, and equipment leases or equipment installment contracts with maturities of up to five years. *E.g.*, *Liberty National Corp.* (avail. May 6, 1983); *Florida Coast Banks* (avail. Sept. 12, 1983). Commercial paper also has been used to finance the construction or development of fixed assets such as large office buildings, pipelines, utility plant additions, and cable television systems where the paper was to be refunded with conventional financing within periods of up to five years. *E.g.*, *Cox Communications, Inc.* (avail. Mar. 15, 1983); *Tucson Electric Power Co.* (avail. Apr. 22, 1983); *Kuparuk Transportation Capital Corp.* (avail. Apr. 25, 1983); *The Equitable Life Assurance Society of the United States* (avail. Oct. 1, 1983). For a period of time, bank holding companies used the proceeds of commercial paper to finance acquisitions of other financial and non-banking businesses. *See Hartford National Corp.* (avail. Oct. 30, 1981); *First Jersey National Corp.* (avail. June 4, 1981); *Marine Midland Banks, Inc.* (avail. Apr. 30, 1981).[12]

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[11] At December 31, 1982, for Goldman Sachs' 10 largest U.S. corporate issuers of commercial paper, the commercial paper outstandings as a percentage of total capitalization ranged from 5.2 percent to 18.5 percent. Aggregate commercial paper outstandings for these issuers constituted 9.95 percent of their total aggregate capitalization.

[12] It is possible to market short-term corporate notes in such a manner as to enable the issuer to use the proceeds for any purpose whatever, including bricks and mortar and other long-term capital expenditures. This may be accomplished by structuring the marketing effort so as to comply with SEC guidelines for a "private placement." At least several billion dollars of such "restricted" commercial paper are believed to be outstanding, with maturity dates and interest costs not significantly different from conventional "current

In sum, it is erroneous to assume that commercial paper differs so plainly from other financing vehicles that it cannot be deemed a part of a corporation's capital structure. To the contrary, commercial paper—"notes"—is an integral and increasingly significant vehicle for the raising of capital. As such, it should not lightly be read out of Glass-Steagall.

B. Section 21 as Interpreted by the District Court Below Leaves Commercial Banks Free To Perform Their Traditional Lending Functions

The court of appeals professed concern that interpreting "notes" in Glass-Steagall Section 21 to include the commercial paper here at issue would lead to unreasonable results, assertedly by removing commercial banks from well-settled banking functions. 693 F.2d at 144 n.48 (J.A. 235). That concern is without basis.

First, interpreting "notes" in Glass-Steagall Section 21 to mean all notes, would, as the district court correctly held, leave commercial banks free to "continue to purchase commercial paper"—*i.e.*, to act as lenders—"as they traditionally have." 519 F. Supp. at 613 n.9 (J.A. 213). Purchasing and discounting commercial paper is an exercise of the banks' classical lending funtion. The activity is expressly authorized to federally chartered banks under the banking laws. 12 U.S.C. § 24, Paragraph Seventh.

Second, the district court's interpretation of Glass-Steagall Section 21 leaves undisturbed the authority of commercial banks to issue evidences of *bank* indebtedness as a necessary adjunct to their traditional lending activities. Section 21 directs its prohibition to entities engaged in "the business of

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transactions" paper. Although a bank's involvement in the marketing of such "restricted" paper raises somewhat different questions under Section 21, the significance of "restricted paper" is that corporate instruments economically identical to commercial paper may be used to finance long-term capital projects on a permanent basis.

receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, *or other evidence of debt*, or upon request of the depositor" (emphasis supplied). Thus, Section 21 presupposes that commercial banks subject to its proscription of defined *marketing* activities will continue to handle the instruments that finance their traditional *lending* function.

Engaging in lending activities is the *raison d'etre* of commercial banks. They remain free, whenever so authorized by their state or federal charters, to issue evidences of their *own* indebtedness to their depositors in the form of certificates of deposit ("CD's"); to guarantee their *customers'* obligations in the form of bankers' acceptances ("BA's"), thereby lending their own credit in support of their customers' business activities; and to arrange syndicates of fellow banks to participate in loan arrangements. Commercial banks commonly issue both "CD's" and "BA's" to generate funds for their basic lending functions. Such instruments are not thought of as "notes" in the conventional sense. *See, e.g.*, U.C.C. §§ 3-104(2), 3-410(1). Thus, they do not fall within the prohibition of Glass-Steagall Section 21.

The court of appeals thought that commercial banks' sales of instruments such as CD's, notes evidencing mortgage loans, and notes representing commercial loans would be prohibited if the term "note" were given its natural meaning of a "written promise . . . to pay a certain sum to the . . . payee." 693 F.2d at 144 n.48 (J.A. 235), *quoting* G. Munn, *Encyclopedia of Banking and Finance* 698 (7th ed. 1973). That analysis is incorrect. As noted earlier in this Brief, the National Bank Act authorizes federally chartered banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking; *by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt.*" 12 U.S.C. § 24, Paragraph Seventh (emphasis supplied). Comparable provisions exist under state law, such as that of New York, to provide statutory authority to state-chartered banks like Bankers Trust to carry on similar activities. N.Y. Banking Law § 96

(McKinney 1971). Thus, the National Bank Act and parallel state legislation provide ample authority to banks to engage in the traditional lending and discounting function reflected in their conventional discounting of note instruments.[13]

III. THE HISTORY OF COMMERCIAL BANKS' INVOLVEMENT WITH COMMERCIAL PAPER CONFIRMS THAT BANKERS TRUST'S MARKETING OF THIRD-PARTY PAPER TO UNRELATED PURCHASERS CONSTITUTES A RADICAL DEPARTURE FROM TRADITIONAL BANK ACTIVITY

One sure guide to Glass-Steagall is the practice of commercial banks since the statute's enactment. So far as we can ascertain, not until Bankers Trust's present venture has any commercial bank undertaken such commercial paper marketing activity after Glass-Steagall's passage.

Bankers Trust's activity differs altogether from the handling of commercial paper in which commercial banks traditionally have engaged. From the inception of the commercial paper market in this country through the turn of the century and into the 1930s, commercial banks were present in the market as *lenders*—that is, as purchasers of commercial paper offered initially by mercantile firms seeking short-term financing to assist in their seasonal production, and then, after the

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[13] The court of appeals also thought that "[i]n recent years, the lender [on commercial borrowings generally] has characteristically been either a bank or a syndicate of lenders, which may include banks and lending institutions such as credit or mortgage companies." 693 F.2d at 149 (J.A. 244) (footnote omitted). To the contrary, loan syndicates typically involve a lead *bank* and participating *banks*. *See, e.g.*, Pollock, *Notes Issued in Syndicated Loans*, 32 Bus. Law. 537, 538 (1977) ("it [may become] necessary for *several banks* to join together in a syndicate to provide the required funds") (emphasis supplied). Goldman Sachs is unaware of any practice whereby commercial banks head up loan syndicates including non-bank participants.

First World War, increasingly by financing entities (such as General Motors Acceptance Corporation and other similar consumer lending institutions) that had a constant need for short-term refinancing of loans into the consumer market.

The court of appeals recognized that Bankers Trust's marketing of commercial paper differs from "the traditional lending of commercial banks," but it dismissed the distinction between purchaser and seller of commercial paper as one in which "[t]he bank is simply on the other side of the transaction." 693 F.2d at 150 (J.A. 246). That analysis reflects a fundamental misreading of history and of economic reality. There is a world of difference between commercial banks' historical lending function and Bankers Trust's newly inaugurated middleman activities. The district court had it right when it said: "[B]ased on the undisputed facts, the role of Bankers Trust in its commercial paper transactions is an uncommon one for traditional banking institutions." 519 F. Supp. at 614-15 (J.A. 215-16).

Numerous authorities make the point that up to the Great Depression, commercial banks were by far the largest single group of investors in commercial paper—*i.e.*, they purchased paper at a discount and thereby acted as lenders in the transactions.[14] Before the district court, the Board forthrightly acknowledged the historic role of commercial banks in the commercial paper market. There it said: "Historical studies of the commercial paper market indicate that . . . commercial

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[14] *See, e.g.*, Cleveland Federal Reserve Bank, *Money Market Instruments* 74 (1970); N. Baxter, *The Commercial Paper Market* 39 (1966); New York Federal Reserve Bank, *Essays in Money and Credit* 67 (1964); *Banking and Monetary Studies* 335, 348 (D. Carson ed. 1963); R. Selden, *Trends and Cycles in the Commercial Paper Market* 2, 9 (1963); A. Greef, *The Commercial Paper House in the United States* 63, 96 (1938); 3 B. Beckhart, *The New York Money Market* 234 (1932); R. Foulke, *The Commercial Paper Market*, ch. III (1931); Steiner, *The Commercial Paper Business*, 7 Fed. Res. Bull. 920, 924 (1921).

paper was the functional equivalent of a bank loan. . . . [It] was sold almost exclusively to commercial banks" (Memorandum in Support of Motion to Dismiss or for Summary Judgment, filed January 19, 1981, at 18-19) (emphasis supplied). The Board confirmed the point in its opening brief in the court of appeals: "[H]istorically commercial paper was purchased *almost exclusively by banks for their own accounts*, and thus represented a commercial loan from a bank" (Brief for Appellant at 10) (emphasis supplied).

Of the commercial banks that invested in commercial paper, by far the preponderant banks in number and amount were the so-called "country banks"—banks that were located outside the Reserve Cities, and that looked beyond their immediate localities for opportunities to invest their customers' deposits. Such banks regularly dealt with commercial paper houses, which maintained solicitation forces in the field to market the commercial paper brought to the houses by the mercantile interests seeking to raise capital. Baxter, *supra*, at 39; Beckhart, *supra*, at 234; Steiner, *supra*, at 923.[15]

On occasion, it appears that commercial banks, including the big city banks, took commercial paper either directly from the issuers or indirectly through commercial paper houses, and placed portions of the paper, or "participations," with other

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[15] As Goldman Sachs advised the courts below, the big city banks played a largely passive and peripheral role in the handling of commercial paper. In the experience of Goldman Sachs, the big city banks did not invest heavily in commercial paper. Rather, their activities were confined to the execution of commercial paper transactions on behalf of their correspondent country banks and pre-existing customers. Such services were rendered as an accommodation. Any fees charged were service fees. The city banks took little commercial paper for their own account. It followed that they resold little, if any, such paper. Thus, at no time were they in the position of marketers looking to the "spread" between the purchase and sale price on the paper as a source of profit for themselves. *See* Baxter, *supra*, at 39; Steiner, *supra*, at 923.

institutions. These participations were with *other banks. See* Greef, *supra*, at 379. Thus, the participations closely resembled the traditional bank process of syndicating corporate loans among correspondent banks. This process of syndication, by which a lead bank introduced correspondent banks to share in a corporate loan transaction, again was entirely consistent with the banks' recognized and traditional *lending* function. *See* Pollock, *Notes Issued in Syndicated Loans—A New Test to Define Securities*, 32 Bus. Law. 537, 538-39 (1977); Baxter, *supra*, at 57; Greef, *supra*, at 63.

* * *

In sum, the contemporaneous commercial experience surrounding the enactment of Glass-Steagall amply corroborates the point graphically made by the statute itself. Commercial banks in the period antedating the Great Depression and continuing through that period handled commercial paper as lenders, not as marketers. Until Bankers Trust's recent foray, commercial banks left to the investment banking houses the business of taking up issues of third-party commercial paper and placing them with prospective investors.

CONCLUSION

For the reasons set forth in this Brief, Goldman Sachs as *amicus curiae* respectfully urges the Court to reverse the judgment of the court of appeals below, with instructions to that court to conduct such other and further proceedings (including remand to the district court) as may be necessary or appropriate.

Respectfully submitted,

G. DUANE VIETH
LEONARD H. BECKER*
DANIEL I. PRYWES
PETER K. KAUTSKY

ARNOLD & PORTER
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

Attorneys for Amicus Curiae Goldman, Sachs & Co.

OF COUNSEL:

JOSEPH MCLAUGHLIN, ESQ.
VICE PRESIDENT-GENERAL COUNSEL
GOLDMAN, SACHS & CO.
85 Broad Street
New York, New York 10004
(212) 902-5732

**Counsel of Record*

November 17, 1983

No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

A. G. BECKER INCORPORATED,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF THE INVESTMENT COMPANY INSTITUTE, *AMICUS CURIAE*

IN SUPPORT OF REVERSAL

LOUIS LOSS
(Counsel of Record)
1545 Massachusetts Avenue
Cambridge, MA 02138
(617) 495-4626

Counsel for Investment Company Institute

MATTHEW P. FINK
Senior Vice President and General Counsel
THOMAS D. MAHER
Assistant General Counsel
INVESTMENT COMPANY INSTITUTE
1775 K Street, N.W.
Suite 800
Washington, D.C. 20006
(202) 293-7700
Of Counsel

November 17, 1983

QUESTION PRESENTED

Did the majority below err in sustaining a ruling by the Board of Governors of the Federal Reserve System (the "Board") that allows banks to underwrite "commercial paper"—which is to say, short-term corporate notes—in the face of the Glass-Steagall Act's express prohibition against banks' underwriting "notes, or other securities"? * The Investment Company Institute ("the Institute") as *amicus curiae* answers "yes."

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*§ 21, 12 U.S.C. § 378(a)(1); *see also* § 16, 12 U.S.C. § 24 (Seventh).

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF THE INVESTMENT COMPANY INSTITUTE, *AMICUS CURIAE*

The Investment Company Institute (the "Institute"), *amicus curiae,* files this brief in support of the Petitioners' prayer that the judgment of the United States Court of Appeals for the District of Columbia Circuit, entered on November 2, 1982, be reversed.[1]

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[1] This brief on behalf of the Institute is filed with the written consent of all the parties. *See* Letter dated November 14, 1983 from James B. Weidner, Esq., to Matthew P. Fink; Letter dated November 14, 1983 from Harvey L. Pitt, Esq., to Matthew P. Fink; and Letter dated November 4, 1983 from Solicitor General Rex E. Lee, Esq., to Matthew P. Fink, all filed with this Brief.

INTEREST OF THE INVESTMENT COMPANY INSTITUTE

The Institute is the national association of open-end investment companies (commonly known as mutual funds), their investment advisers and their principal underwriters. The Institute has 884 investment company members, with approximately 16 million shareholders and assets of approximately $264.5 billion. The Institute is generally recognized as the primary spokesman for the mutual fund industry and, as such, has been intimately involved over the years in numerous judicial and administrative proceedings with respect to the scope and application of the Glass-Steagall Act, including two cases decided by this Court. *See Board of Governors of the Federal Reserve System* v. *Investment Company Institute,* 450 U.S. 46 (1981) ("Board of Governors"); *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971) ("Camp").

The Institute has a substantial interest in this case because its members are directly and adversely affected by the unprecedented interpretation of the Glass-Steagall Act announced by a divided panel of the court below.[2] Although the members of the Institute do not underwrite commercial paper, they are concerned that the language and rationale of the majority opinion will be applied to authorize incursions by banks into other areas of the securities business forbidden to them by Congress exactly fifty years ago. There are already indications that this concern is well-founded. *See* Joint Petition for Writ of Certiorari at 11-12.[3]

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[2] At least since *Association of Data Processing Service Organizations, Inc.* v. *Camp,* 397 U.S. 150 (1970), there can be no doubt that the Institute would have had standing below even as a party. The Court there held that a trade organization's competitive position gave it standing to challenge a ruling of the Comptroller of the Currency that national banks could make data processing services available to their customers and to other banks. Indeed, in *Camp,* this Court applied *Data Processing* to hold squarely that the Institute and its members have standing to challenge interpretations of the Glass-Steagall Act issued by the banking regulators. *See Camp, supra,* 401 U.S. at 620-621.

[3] Specifically, the Comptroller of the Currency recently issued a ruling authorizing national banks to create mutual funds and to mass-market shares

(footnote continues)

The members of the Institute are further aggrieved by the majority's delegation of authority to the federal banking regulators to "adapt" the Glass-Steagall Act on a "case-by-case basis" to the regulators' view of "current business reality" (J.A. 228). In 1933, Congress determined that it was necessary to effect the divorcement of commercial and investment banking and proceeded to enact separate but intertwined statutory schemes to govern and regulate each industry. No administrative agency possesses the authority to question the Congressional judgment to separate commercial from investment banking, and the delicate interrelationship between Glass-Steagall and the securities laws confirms that no administrative agency possesses the expertise necessary to rework Congress' legal and regulatory superstructure. The Institute believes that the difficult issues of fair competition, concentration of economic power, and investor protection raised by any adjustment of the statutory framework are issues that must be addressed by Congress, and by Congress alone.

Finally, the Institute submits this brief because its members possess a perspective upon the issues before this Court that is not shared by the parties to this case. Quite apart from the Institute's experience with the Glass-Steagall Act, its members are acknowledged experts in the buying, holding and selling of commercial paper. Indeed, its money market fund members alone own approximately 28% of all the commercial paper outstanding in the United States. Through their experience in the commercial paper market, the Institute's members have acquired a unique appreciation of the risks inherent in the

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(footnote continued)

in the funds to the 111 million members of the nation's workforce as investments for their Individual Retirement Accounts, even though this Court squarely held in *Camp* that bank operation of a mutual fund is unlawful because it involves banks "in the underwriting, issuing, selling, and distributing of securities in violation of §§ 16 and 21 of the Glass-Steagall Act." *Camp, supra,* 401 U.S. at 639. During the course of the ensuing litigation challenging the Comptroller's ruling, the Comptroller has attempted to justify his defiance of *Camp* by relying upon the majority opinion below. *See* Reply Brief in Support of Joint Petition for Writ of Certiorari at 2 n.1.

purchase and sale of commercial paper, issues squarely raised by the majority decision below.[4]

OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit (J.A. 220-257) [5] is reported at 693 F.2d 136. The decisions of the Court of Appeals for the District of Columbia Circuit denying, by a split vote, a joint petition for rehearing (J.A. 258) and suggestion for rehearing *en banc* (J.A. 260) are unreported.

The opinion of the United States District Court for the District of Columbia granting summary judgment in favor of petitioners (J.A. 194-219) is reported at 519 F. Supp. 602. The administrative determination of the Board of Governors of the Federal Reserve System ("Board") in response to petitions by A. G. Becker Incorporated and the SIA (J.A. 122-143) is unreported, and the Board's subsequent "Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks" (J.A. 183-189) is reported at 46 Fed. Reg. 2933 (June 1, 1981).

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on November 2, 1982. A timely petition for a writ of certiorari was filed on April 29, 1983, and was granted on October 3, 1983. The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

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[4] This Court's decision in *Burks* v. *Lasker*, 441 U.S. 471 (1979), arose out of a suit brought by a mutual fund shareholder against the fund's investment adviser to recover losses sustained by the fund when $20 million in "prime quality" Penn Central commercial paper owned by the fund had declined dramatically in value upon Penn Central's bankruptcy. *See id.* at 473-475.

[5] Citations herein to material printed in the Joint Appendix appear as "J.A.   ."

STATUTES INVOLVED

Involved in these actions are two sections of the Glass-Steagall Act.[6] Section 16 of the Act provides, in part:

> [A national bank] shall not underwrite any issue of securities or stock; * * *.

12 U.S.C. § 24 (Seventh) (Supp. 1982). Section 21 of the Act provides, in part:

> [I]t shall be unlawful * * * [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor * * *.

12 U.S.C. § 378(a)(1).

STATEMENT OF THE CASE

The Institute adopts the Statement of the Case presented in the Briefs of Petitioners A. G. Becker Incorporated and the Securities Industry Association.

SUMMARY OF ARGUMENT

I. The reference in the Glass-Steagall Act to "stocks, bonds, debentures, notes, or other securities" is so categorical and all-encompassing that the Court of Appeals' decision

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[6] What is generally known as the Glass-Steagall Act was enacted as part of the Banking Act of 1933, 48 Stat. 162, and is codified in various sections of Title 12 of the United States Code. Relevant to this action are §§ 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh) and 378. The terms of § 16, which expressly apply to national banks, are also made applicable to state member banks of the Federal Reserve System, such as Bankers Trust Company, by 12 U.S.C. § 335.

permitting banks to underwrite commercial paper contravenes the "plain meaning" of the Glass-Steagall Act. This is clear from (1) the face of the statute, (2) the absence of any legislative history to the contrary, (3) the absence of any statutory grant of rulemaking authority to the Board (or any other banking agency), (4) this Court's repeated admonitions that the Glass-Steagall prohibitions are not to be accorded a narrow or technical meaning, and (5) the contrast between the categorical imperative of the Glass-Steagall Act and the extreme flexibility of the federal securities statutes.

II. For many of the same reasons—and because the term "note" here is not found in an administrative *rule* but is a statutory term central to the entire application of the Act—the Board's administrative construction is entitled to little deference.

III. It is particularly inappropriate to permit the Board to unsettle decades of "plain meaning" construction of the Glass-Steagall Act in view of Congress' steadfast and repeated refusal over the years to jettison the Act or to alter the philosophy it embodies. This is especially true in light of the effect of permitting the Board to do so; for any expansion of bank securities activities necessarily unbalances the regulatory scheme Congress crafted when, in reliance upon the Glass-Steagall Act, it excluded banks from the definitions of "broker" and "dealer" in the Securities Exchange Act of 1934. The realignment of the commercial banking and securities industries is a matter for the Legislative Branch.

IV. The majority opinion below contravenes the Glass-Steagall Act in concluding that commercial paper does not fall within the term "securities." Even if it were assumed, as the Board argues, that it is appropriate to construe the statutory language by means of a "functional analysis," the analysis must focus upon the *role* of the bank in the transaction at issue. The bank's role as a *marketer* or *promoter* of commercial paper is very different from its traditional role as a *buyer* of commercial paper, where it is simply engaged in the traditional banking function of making a loan. The bank's function here confirms that commercial paper is a Glass-Steagall "security."

ARGUMENT

I. THE DECISION BELOW CONTRAVENES THE "PLAIN MEANING" OF THE GLASS-STEAGALL ACT

There is no single rule of statutory construction. We are quite cognizant of Judge Learned Hand's warning "not to make a fortress out of the dictionary,"[7] and of the oft quoted bit of Holmesiana: "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used."[8]

At the same time, the Court has declared in at least nine cases in the securities field alone during the last few years that "analysis must begin with the language of the statute itself."[9] And the Court's adherence to the statutory language has been even more insistent in construing the Glass-Steagall Act. There the Court has instructed that the judicial task is to apply "the literal terms"[10] of the Act "as they were written."[11] Indeed, the Court only recently reminded that the courts must rely "squarely on the literal language of §§ 16 and 21 of the Glass-Steagall Act" and must enforce the Act strictly when "the statutory language plainly applie[s]."[12]

There is no gainsaying that every statute falls somewhere on the continuum between the "plain meaning" and the "statutory purpose" (or, as the Board would have it, the "functional") approaches to statutory construction. In *Camp*, however, this Court decided that the Glass-Steagall Act falls at

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[7] *Cabell* v. *Markham*, 148 F. 2d 737, 739 (2d Cir.), *aff'd*, 326 U.S. 404 (1945).

[8] *Towne* v. *Eisner*, 245 U.S. 418, 425 (1918).

[9] *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 24 (1977); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *SEC* v. *Sloan*, 436 U.S. 103, 111 (1978); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979); *Transamerica Mortgage Advisers, Inc.* v. *Lewis*, 444 U.S. 11,16 (1979); *Chiarella* v. *United States*, 445 U.S. 222,226 (1980); *Steadman* v. *SEC*, U.S. 91,97 (1981); *see also Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring);

[10] *Camp*, *supra*, 401 U.S. at 639.

[11] *Id.*

[12] *Board of Governors*, *supra*, 450 U.S. at 65.

the "plain meaning" end of the continuum. And we suggest for a number of reasons that the case at Bar confirms the wisdom of that decision.

First: It would be difficult to think of anything plainer on its face, as a matter of simple English, than § 21's foreclosure to commercial banks of the business "of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities." Moreover, the reach of § 16 is coextensive with that of § 21.[13] Given the clear and all-encompassing statutory language, one does not have to be a confirmed literalist to suggest that language so plain puts a severe burden on those who would turn the textual white into the "functional" black by reading a huge congeries of "notes" out of the statute.

Second: Even on the assumption *arguendo* that the face of the statute is sufficiently ambiguous to warrant recourse to the legislative history of the Glass-Steagall Act, it is fair to say that the search is fruitless. The Board concedes that "there is no direct evidence in the legislative history of the Glass-Steagall Act on the status of commercial paper under the Act" (J.A. 133).[14]

There is, nevertheless, compelling evidence that Congress intended the statutory language to encompass commercial paper. During floor consideration of the bill that became the Securities Act of 1933, Senator Glass, supported by the Federal Reserve Board, expressed concern over the fact that the proposed definition of the term "security"—which included "any note"—would encompass commercial paper. Accordingly, he proposed (in the Board's words) that "short-term notes, in-

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[13] *A. G. Becker Incorporated* v. *Board of Governors of the Federal Reserve System*, 519 F. Supp. 602, 613-613 (D.D.C. 1981), *rev'd on other grounds*, 693 F.2d 136 (D.C. Cir. 1982). It is noteworthy in this regard that, despite minor language differences in the definition of the term "securities" contained in the Securities Act of 1933 and the Securities Exchange Act of 1934, this Court also has construed those definitions together. *See, e.g., United Housing Foundation, Inc.,* v. *Forman*, 421 U.S. 837, 848 n. 12 (1975); *Tcherepnin* v. *Knight*, 389 U.S. 332, 336, 342 (1967).

[14] The evidence adduced by the majority below is anything but direct. *A. G. Becker Incorporated* v. *Board of Governors of the Federal Reserve System*, 693 F.2d 136, 144-146 (D.C. Cir. 1982) (J.A. 236-238).

cluding '9 months' commercial paper,' be excluded from the definition of securities contained in that bill" (J.A. 133).

Congress, however, refused to adopt the proposed amendment. Instead, it merely exempted some forms of commercial paper from the *registration* requirements of the Securities Act,[15] leaving untouched the status of all commercial paper as securities,[16] and leaving intact the application of the antifraud provisions of the Securities Act to the purchase and sale of all commercial paper "securities."[17] The battle having been lost once, when the same committees of the same Congress considered the Glass-Steagall Act three weeks later, no one, including Senator Glass and the Board, sought to amend the word "notes" or "securities" to exclude commercial paper from the class of corporate instruments that the Glass-Steagall Act forbids commercial banks to sell, distribute, deal in or underwrite.

Third: The terms of the statute should be applied, in the Court's words, "as they were written,"[18] because Congress expressly has refused to provide the Board with any definitional rulemaking authority. In contrast to the Bank Holding Company Act, 12 U.S.C. §§ 1841, *et seq.,* which vests rulemaking authority in the Board to define, and to authorize bank holding companies to engage in, activities that the Board considers to be "so closely related to banking as to be a proper incident thereto"—as well as the provisions in five of the six securities

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[15] *See* §§ 3(a)(3), 5, 15 U.S.C. §§ 77c(a)(3), 77e.

[16] *See* H.R. Rep. No. 85, 73d Cong., 1st Sess. 14 (1933) (§ 3(a) "lists securities that are exempt * * *.")

[17] *See* §§ 12(2), 17(c), 15 U.S.C. §§ 77l(2), 77q(c); *see also* the remarks of Senator Adams in *Hearings on S. 875 before the Senate Com. on Banking & Currency,* 73d Cong., 1st Sess. 234 (1933): "You would recognize the propriety, would you not, of the fraud sections being made applicable even to commercial paper? In other words, you have in Chicago, as you know, note brokers * * *. And if one of those note brokers, some intermediary, should misuse these things, misuse the mails, I take it you would concede it would be proper to provide for prosecution of them, even though you do not think he should be required to make a registration of these securities."

[18] *Camp, supra,* 401 U.S. at 639.

statutes authorizing the SEC to define "accounting, technical, and trade terms" used in the statutes[19]—the Glass-Steagall Act contains only flat prohibitions with no rulemaking flexibility.

This denial of authority to the Board was not for lack of rulemaking proposals, both when the statute was originally enacted and on several occasions since. *See* Joint Petition for Writ of Certiorari at 24-26. Indeed, Congress only recently reaffirmed its opposition to vesting such authority in the banking agencies in enacting the Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat. 132, where it authorized the Comptroller of the Currency to adopt rules to "carry out the responsibilities of the office" but expressly negated any rulemaking authority with respect to "securities activities of National Banks under * * * the Glass-Steagall Act." 12 U.S.C. § 93a.

To be sure, the Board purports to have proceeded here by way of "interpretation" rather than rules. But the error in this assertion is betrayed both by (1) the lack of any relationship between the Board's interpretation ("long-term, speculative debt instruments with maturities of greater than 270 days sold to sophisticated institutional investors and used for raising capital as part of the permanent financial structure of a corporation") and the statutory language ("notes"), and (2) the elaborate "guidelines" promulgated by the Board in an attempt to "minimize" the unsafe and unsound banking practices that the Board conceded would flow from the commercial paper underwriting activity it had authorized (J.A. 185-189).

Fourth: The applicability of the "plain meaning" approach is also implicit in this Court's admonition, ***in every case that has construed the Glass-Steagall Act,*** that its prohibitions are not to

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[19] Securities Act of 1933, § 19(a), 15 U.S.C. § 77s(a); Securities Exchange Act of 1934, §§ 3(b), 23(a), 15 U.S.C. §§ 78c(b), 78w(a); Public Utility Holding Company Act of 1935, § 20, 15 U.S.C. § 79t; Trust Indenture Act of 1939, § 319(a), (b), 15 U.S.C. §§ 77sss(a), (b); Investment Company Act of 1940, §§ 38(a), 39, 15 U.S.C. §§ 80a-37(a), 38. These provisions are in addition to the general rulemaking authority in all six statutes to adopt such rules as may be necessary to carry out the Commission's statutory functions. *Id.;* Investment Advisers Act of 1940, § 211(a), (b), 15 U.S.C. § 80b-11(a), (b). Moreover, numerous *exemptive* powers are scattered throughout the statutes. See 1 American Law Institute, *Federal Securities Code* 237 (1980), source note to § 303(c), which enumerates no fewer than 28 instances.

be accorded a narrow or technical meaning.[20] In construing the very term "securities" as used in the Act, the Court has stated that

> there is nothing in the phrasing of either §16 or § 21 that suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.

Camp, supra, 401 U.S. at 635.

Fifth: The "plain meaning" approach to the Glass-Steagall Act is demonstrated also by a comparison of that Act and the Securities Act of 1933. The definitional section of the Securities Act is introduced by the phrase, "unless the context otherwise requires." § 2(1), 15 U.S.C. § 77b(1). *See SEC* v. *C.M. Joiner Leasing Corp.,* 320 U.S. 344, 350-51 (1943); *SEC* v. *National Securities, Inc.,* 393 U.S. 453, 466 (1969); *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 848. It is by relying upon this language that some courts have held that not all notes are "securities" within the Securities Act of 1933, notwithstanding the fact that the Securities Act definition of the term "securities" includes "any note."[21] By contrast, even though Congress invited the Board and the courts to consider whether "the context otherwise requires" in construing the terms of *other* banking statutes—the Savings & Loan Holding Company Act, for example[22]—Congress extended no such invitation *to anyone* in the Glass-Steagall Act. The statutory terms of the Glass-Steagall Act, including the term "notes," therefore must be applied "as they were written." *Camp, supra,* 401 U.S. at 639.

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[20] *Board of Governors of Federal Reserve System* v. *Agnew,* 329 U.S. 441, 450 (1947); *Camp, supra,* 401 U.S. at 635; *Board of Governors, supra,* 450 U.S. at 65; *see also Awotin* v. *Atlas Exchange National Bank,* 295 U.S. 209, 212 (1935) (construing the McFadden Act, 44 Stat. 1224 (1927), reenacted as part of the Glass-Steagall Act).

[21] 1933 Act § 2(1), 15 U.S.C. § 77b(1). For a collection of the cases and the several theories, see *SEC* v. *Diversified Industries, Inc.,* 465 F. Supp. 104 (D.D.C. 1979). *See also* L. Loss, *Fundamentals of Securities Regulation* 170, n. a (1983).

[22] *See, e.g.,* 12 U.S.C. § 1730a(a)(1). *See also* 12 U.S.C. § 1749bbb-2(a).

II. THE BOARD'S ADMINISTRATIVE CONSTRUCTION IS ENTITLED TO LITTLE DEFERENCE UNDER THE CIRCUMSTANCES

This second proposition is a corollary o[illegible]. And much of what has been said there with resp[illegible] the interpretative approach to the statute is just as cogent with respect to the degree of deference to be extended to the administrative interpretation of the Board.

First: The Board's construction, contravening, as it does, the plain language of the statute, is entitled to little respect, because the Board has failed to uncover any "clearly expressed legislative intention" that Congress did not intend its words to mean what they say. *See, e.g., American Tobacco Co.* v. *Patterson,* 456 U.S. 63, 68 (1982). As a result, talk of deference simply is "pointless." *FEC* v. *Democratic Senatorial Campaign Committee,* 454 U.S. 27, 31 (1981).[23]

Second: Another reason that the Board's interpretation is entitled to little deference is the nature of the term it has construed. This is not the case of an agency's interpretation of one of its own rules, where presumably it knows what it intended. There the administrative construction may be of "controlling weight unless it is plainly erroneous or inconsistent with the regulation."[24] This is a case involving the construction of a *statute,* where, as this Court only recently reminded, the "courts are the final authorities."[25]

Moreover, as a statutory term, the word "note" is not more or less peripheral. It is central to the entire application of the statute. And even a consistent and longstanding administrative

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[23] In that case, the Court agreed with the administrative construction. But this is not true of all the cases cited by the Court. *See, e.g., SEC* v. *Sloan,* 436 U.S. 103 (1978).

[24] *Bowles* v. *Seminole Rock & Sand Co.,* 325 U.S. 410, 414 (1945); *see also Udall* v. *Tallman,* 380 U.S. 1, 16-17 (1965). Even in that situation the Court more recently has said that the SEC's view of "materiality" for purposes of its proxy fraud rule was merely "entitled to consideration." *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438, 499 n. 10 (1976).

[25] *FEC* v. *Democratic Senatorial Campaign Committee, supra,* 454 U.S. at 32.

construction of such a term should not be entitled to great deference. The meaning of "note" does not require delving into such technical mysteries as the electronic marvels of bank clearing operations or the functions of stock exchange specialists—areas of the kind that might be expected to repel the bravest of judges in the face of an agency's special expertise. But the courts know what a bond is, what a stock is, what a note is, what commercial paper is.

On one ground or another, this Court did not defer to the SEC's construction of the equally central term, "security," in two of the last three cases under the securities laws involving that word. *United Housing Foundation, Inc.* v. *Forman, supra,* 421 U.S. at 858 n. 25; *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 565-566 (1979). Nor should it defer to the Board's construction here.

Third: In any event, the administrative construction here is anything but consistent and longstanding. The Board is not the SEC, which not only has to interpret hundreds of pages of rules but also has its staff issue thousands of interpretive "no action" letters every year. Quite apart from the fact that the Board's policy statement here at issue dates only from 1981 (J.A. 183), there has been only a relative handful of Board letters on §§ 16 and 21 generally during the entire life of the Glass-Steagall Act.

III. THIS IS A PARTICULARLY INAPPROPRIATE TIME FOR THE BOARD TO UNSETTLE FIFTY YEARS OF CONSTRUCTION OF THE BANKING AND SECURITIES LAWS IN VIEW OF THE CURRENT DEBATE IN CONGRESS ON THE ENTIRE GLASS-STEAGALL PHILOSOPHY

First: Perhaps the beat reason of all to stick to the unqualified language of the Act is that, although Congress in recent years has been actively reexamining the Glass-Steagall Act not only from many facets but also in its entirety, it steadfastly has refused to abandon the Act or to alter its complete divorcement philosophy. *See* Joint Petition for Writ

of Certiorari at 14. Thus, through a narrow construction of the Act's categorical language, the Board in effect has entered where Congress has refused to tread. Yet, as this Court recently has stated, policy decisions "must be implemented by Congress, and not by a crabbed interpretation of the words of a statute." *BankAmerica Corp.* v. *United States*, 103 S.Ct. 2266, 2273 (1983).

Second: Adherence to the plain statutory language is essential to preserve the careful balance Congress has constructed between the securities laws and the Glass-Steagall Act. The Securities Act of 1933 was enacted just three weeks before the Glass-Steagall Act; they both came out of the Senate Banking and Currency Committee; and President Roosevelt's 1933 message to Congress that led to passage of the Securities Act specifically noted the interrelationship by describing the Securities Act as "but one step in our broad purpose of protecting investors *and depositors.*" H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933) (italics supplied).[26]

This interrelationship extends to the Securities Exchange Act of 1934. Because Congress believed that the Glass-Steagall Act prohibited commercial banks from engaging in the securities business, Congress excluded banks from the definitions of the terms "broker" and "dealer" in the Securities Exchange Act.[27] This exclusion places them outside a comprehensive statutory scheme that starts with registration and extends to many kinds of regulation—both direct regulation by the SEC and self-regulation (under the aegis of the Commission) by the so-called "self regulatory organizations": the stock exchanges, the National Association of Securities Dealers, and the registered clearing agencies. *See generally* L. Loss, *supra*, c. 8B-D.

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[26] *Accord:* 77 Cong. Rec. 5896 (1933) (statement by Senator Luce that Glass-Steagall Act's "purpose is, by an extension revision of our banking laws, to furnish more protection to depositors and investors * * *"); *see also* Federal Reserve Board, *Commercial Bank Private Placement Activities; A Staff Study* 91 (June 1977) ("Glass-Steagall's concerns were not limited to the protection of investors * * *"); *see generally* Willis, *The Banking Act of 1933 in Operation*, 34 Colum. L. Rev. 697, 705 (1935).

[27] *See* § 3(a)(4), 3(a)(5), 15 U.S.C. §§ 78c(a)(4), 78c(a)(5). Mr. Thomas G. Corcoran, the Administration's spokesman, testified in the 1934 Senate committee hearings:

(footnote continues)

Under these circumstances, to permit the Board to disregard the plain language of the Glass-Steagall Act and to authorize banks to engage in the securities business would be an erosion of what Congress envisaged in § 2 of the Securities Exchange Act of 1934, 15 U.S.C. § 78b, as a scheme of "regulation and control [that would be] reasonably complete and effective." Moreover, it necessarily would undermine what the District Court termed in *Camp* "the complete regulatory scheme which the Congress enacted to mitigate the problems that the country faced in the 1930s." *Investment Company Institute* v. *Camp,* 274 F. Supp. 624, 642-643 (D.D.C. 1967), *rev'd,* 420 F.2d 83 (D.C.Cir. 1970), *rev'd,* 401 U.S. 617 (1971).

Indeed, administrative rulings such as that issued by the Board here have already prompted the SEC to embark on its own voyage of statutory exploration in an attempt to redress the resulting regulatory imbalance. For example, the SEC has thought it necessary to hold hearings on whether to require banks, notwithstanding their exclusion from the definitions of "broker" and "dealer," to register and submit to SEC regulation if they engage in certain securities activities. In the words of the SEC:

> The term "broker" and "dealer" are defined in the Securities Exchange Act of 1934 to exclude banks. The Exchange Act's definitions are preceded, however, by the phrase "unless the context otherwise

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(footnote continued)

> * * * there are plenty of other limitations on the banks. A bank cannot normally go in the business, like a broker, of dealing in securities * * *.
>
> * * *
>
> They are not allowed to do those things any longer, under the Glass-Steagall bill. They cannot go into a business of dealing in securities * * *.

Hearings on H.R. 7852 and H.R. 8720 before House Com. on Interstate & Foreign Commerce, 73d Cong., 2d Sess. 86 (1934). *See also* H.R. Rep. No. 123, 94th Cong., 1st Sess. 93 (1975): "Since 1934, banks have been excluded from the definition of 'broker' and 'dealer' under the Securities Exchange Act. It had been thought that the Glass-Steagall Act had effectively removed banks from the securities business."

> requires." The Commission will consider whether the context requires that the bank exclusion not be available if banks engage in * * * securities activities.[28]

And, on November 8, 1983, the SEC issued for public comment proposed rules which would require banks to register as broker-dealers.[29]

While the SEC is understandably trying to plug the regulatory gap created by the recent rulings of the banking regulators, all such *ad hoc* administrative adjustments provide a poor substitute for the carefully balanced statutory scheme created by Congress. If the present reciprocal relationship of the Glass-Steagall Act and the Securities Exchange Act of 1934 is to be disturbed, Congress, not the Board, is the proper body to evaluate and balance the complex considerations that an alteration of the statutory framework would entail.

Third: The Court's teaching in *International Brotherhood of Teamsters* v. *Daniel, supra,* 439 U.S. at 569-570, and *Marine Bank* v. *Weaver,* 455 U.S. 551, 560 n. 1 (1982), is instructive. There the Court referred to federal pension and banking regulation as reasons for holding that certain pension plan interest and bank certificates of deposit, respectively, were not "securities" within the SEC statutes. Here, conversely, a potential condition of *no* regulation—the fact that banks' underwriting activities would *not* be subject to federal regulation of the securities type by either the SEC or the Board—is reason for holding that short-term notes known as commercial paper *are* Glass-Steagall "securities."

Fourth: The "leave it to Congress" approach was determinative for the Second Circuit in deciding that certain custom-tailored promissory notes were not "securities" within the 1933 and 1934 securities statutes. *Exchange National Bank* v. *Touche Ross & Co.,* 544 F.2d 1126 (2d Cir. 1976). After giving a number of examples of notes that normally would not be "securities," Judge Friendly stated that "A more desirable solution would be for Congress to change the exclusions" from the "security" concept along the lines of The American Law

[28] SEC Press Release, Oct. 19, 1983.

[29] 48 Fed. Reg. 51,930 (November 15, 1983).

Institute's *Federal Securities Code.* But, he went on, "So long as the statutes remain as they have been for over forty years, courts had better not depart from their words without strong support for the conviction that, under the authority vested in them by the 'context' clause, *they are doing what Congress wanted when they refuse to do what it said.*" 544 F.2d at 1138 (italics supplied).

That is the essence of our position. It is now fifty years since Glass-Steagall was placed in the statute book. And it is significant that during all that time, until 1978, it did not apparently occur to banks that they could underwrite third-party debt of any kind. There is simply no history making the underwriting of commercial paper a traditional banking function.

Just during its past term the Court preferred the "plain meaning" of § 8 of the Clayton Act, 15 U.S.C. § 19, to a Government interpretation that was at odds with the Government's failure for more than sixty years to exercise the power that it belatedly claimed. *BankAmerica Corp.* v. *United States, supra,* 103 S. Ct. at 2272; *see also International Brotherhood of Teamsters* v. *Daniel, supra,* 439 U.S. at 565-569. The same preference should attach here.

IV. THE MAJORITY OPINION CONTRAVENES THE GLASS-STEAGALL ACT IN PERMITTING BANKS TO UNDERWRITE SHORT-TERM COMMERCIAL PAPER AS NOT CONSTITUTING "SECURITIES"

Deprived of its "functional analysis" and "administrative deference" props, the Board's case has little left to it. And we shall not add to the Court's reading burden by repeating the more than adequate refutation in the Petitioners' Briefs. In endorsing that refutation, we shall confine ourselves to briefly emphasizing three points:

First: When the majority below blur the distinction between a bank's *buying* and its *marketing* or *promoting* commercial paper by considering the bank as being simply "on the other side of the transaction" in the former case, 693 F.2d at 150 (J.A. 246), we suggest, with respect, that they beg the question. For the critical difference between commercial and investment banking turns on the bank's *role,* not on the size or

riskiness of the transaction or the financial sophistication of the customer.[30]

When a bank *buys* commercial paper, it is in substance lending money to the maker of the note. Its revenue comes from the interest (or discount), and its sole concern is to assess the loan as a risk. On the other hand, when a bank *underwrites* the sale of another person's commercial paper, its role shifts from lender to marketer. Its revenue (normally an agent's commission) depends on its success in placing the paper. And all that is at risk is its reputation, together with potential civil liability, if one or more of its underwritten issues should turn sour as in the Penn Central case of recent memory. [31]

Moreover, banks' underwriting of commercial paper involves potentially both new conflicts of interest and new liabilities.

So far as new conflicts are concerned, consider the example of a bank that sells to Customer *X* paper issued by Customer *Y*, each of which may also have loans outstanding at the bank.

So far as new liabilities are concerned, § 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l(2), which makes sellers of securities liable to their buyers for misstatements in "a prospectus or oral communication" and specifically applies by its terms to commercial paper exempted from registration by § 3(a)(3), 15 U.S.C. § 77c(a)(3), is more strict than common law deceit in that § 12(2) does not require the plaintiff to prove scienter but imposes on the defendant the burden of going forward with a defense of due care.[32]

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[30] *See* Note, *A Conduct-Oriented Approach to the Glass-Steagall Act*, 91 Yale L.J. 102 (1981).

[31] *See* Staff Report of SEC to Special Subcom. on Investigations, H.R. Com. on Int. & For. Commerce, *The Financial Collapse of the Penn Central Company* (Subcom. Print 1972).

[32] Indeed, the Seventh Circuit has equated an underwriter's duty of care under § 12(2) with his duty with respect to a false registration statement under § 11, 15 U.S.C. § 77k. *Sanders* v. *John Nuveen & Co.*, 524 F.2d 1064 (7th Cir. 1975), *cert. denied*, 450 U.S. 1005 (1981). This holding may be questioned—particularly the court's reference to the defendant's failure to verify the audited financial statements or to review the auditor's work papers, since those steps are not required even to erect a defense under § 11(b)(3)(C). But obviously the Court is not going to decide that question in this case. And as long as a Circuit Court opinion is on the books, there is a real risk of substantial civil liability. On §§ 11 and 12(2), *see* L. Loss, *supra*, c. 10E.

Second: If the determining factors with respect to the existence of a Glass-Steagall security are size, riskiness and customer sophistication, what is to prevent the Board from extending its commercial paper reasoning to other debt instruments—say, prime quality corporate debentures and bonds—by pronouncing that they are not really "debentures" or "bonds"?

Third: Allowing the majority opinion to stand will almost inevitably encourage not only the Board but also the other federal bank regulators (the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board) to permit a variety of securities activities previously understood to be barred to banks. At the very least, it will make it harder for all three agencies to resist the banks' strenuous pressure to dismantle the Glass-Steagall Act through administrative "interpretation." *See* Joint Petition for Writ of Certiorari at 15-16.

CONCLUSION

The judgment of the Court of Appeals should be reversed and the District Court's declaratory judgment that the Board's ruling was contrary to law should be reinstated.

Respectfully submitted,

/s/ LOUIS LOSS

(Counsel of Record)
1545 Massachusetts Avenue
Cambridge, MA 02138
(617) 495-4626

Counsel for Investment Company Institute

MATTHEW P. FINK
Senior Vice President and General Counsel
THOMAS D. MAHER
Assistant General Counsel
INVESTMENT COMPANY INSTITUTE
1775 K Street, N.W.
Suite 800
Washington, D.C. 20006
(202) 293-7700
Of Counsel

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No. 82-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

v.

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Respondents.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS AMICI CURIAE

ROBERT S. RIFKIND
(Counsel of Record)
STEPHEN S. MADSEN
ELIZABETH S. STONG
One Chase Manhattan Plaza,
New York, N.Y. 10005
(212) 422-3000

Attorneys for The New York Clearing House Association and The American Bankers Association as Amici Curiae

CRAVATH, SWAINE & MOORE,
One Chase Manhattan Plaza,
New York, N.Y. 10005

DEBORAH S. PRUTZMAN,
General Counsel,
The New York Clearing
House Association,
100 Broad Street,
New York, N.Y. 10004

WILLIAM H. SMITH,
General Counsel and Secretary,
MICHAEL F. CROTTY,
Assistant General Counsel—Litigation,
American Bankers Association,
1120 Connecticut Avenue, N.W.,
Washington, D.C. 20036

Of Counsel.

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BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION AND THE AMERICAN BANKERS ASSOCIATION AS AMICI CURIAE

INTEREST OF AMICI CURIAE

The New York Clearing House Association (the "Clearing House") is an association of twelve leading commercial banks

that are located in New York City.[1] The Clearing House operates electronic payment systems and clears commercial drafts and items in the New York area. The American Bankers Association (the "ABA") is the national organization of banking, numbering within its membership some 13,600 or approximately 91 percent of the nation's commercial banks. Both associations file briefs as amici curiae in appeals that raise significant questions of banking law. The Clearing House appeared as amicus curiae before the Court of Appeals for the District of Columbia Circuit in this action.

Members of the Clearing House and the ABA have a direct and vital interest in the proper interpretation of Federal banking statutes such as the Glass-Steagall Act. These associations, together with their constituent members, believe that the decision of the Court of Appeals correctly interprets the Glass-Steagall Act and sustains the lawful exercise of commercial banking powers. The Clearing House and the ABA further believe that the views presented in this brief will significantly aid the Court in its consideration of issues arising under the Glass-Steagall Act.

INTRODUCTION

The decision below correctly held that the commercial paper obligations placed by Bankers Trust Company ("Bankers Trust") do not constitute "securities" within the meaning of §§ 16 and 21 of the Banking Act of 1933 (the "Glass-Steagall Act" or "Act"), 12 U.S.C. §§ 24, 378 (1982), and that the action of the Board of Governors of the Federal Reserve System (the "Board") in declining to initiate cease and desist proceedings with respect to Bankers Trust's commercial paper activities was therefore lawful. Supplementing the arguments

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[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, National Westminster Bank and European American Bank & Trust Company.

presented by the Board and Bankers Trust concerning the inapplicability of the Glass-Steagall Act to Bankers Trust's commercial paper activities, this brief shows that the meanings assigned to the operative statutory terms by the petitioners are not the meanings assigned to them by the Glass-Steagall Congress, and that those terms, as properly understood by the Court of Appeals, do not encompass commercial paper.

The question before this Court is whether commercial paper is a "security" within the meaning of the Glass-Steagall Act. Because commercial paper consists primarily of negotiable promissory notes, petitioners would have this Court assume that commercial paper obligations are necessarily "notes" and, therefore, "securities" within the meaning of § 21 of the Act, 12 U.S.C. § 378 (1982), which forbids commercial banks to underwrite issues of "stocks, bonds, debentures, *notes,* or other securities" (emphasis added). As the Court of Appeals correctly held, however, the relevant provisions of the Glass-Steagall Act have no bearing on commercial paper. They were intended to limit the ability of commercial banks, institutions of the commercial credit markets, to undertake certain activities in the capital finance markets. Commercial paper transactions take place within the commercial credit markets, a traditional sphere of commercial bank activity, not in the capital finance markets, the traditional domain of investment bankers. As we show below, petitioners' assumption that commercial paper obligations are "notes" within the purview of the Glass-Steagall Act, and the conclusion flowing from it—that such obligations are therefore "securities"—are both fundamentally mistaken.

SUMMARY OF ARGUMENT

1. The term "note" may be used in finance to refer either to commercial paper or to a type of capital security that closely resembles a bond or debenture. The context in which the Glass-Steagall Act employs the term clearly indicates that it refers only to the latter type of "note", and that the Act does not encompass commercial paper either as a "note" or as a "security". In drafting the Act, Congress had no reason to include commercial paper as a "security", for it was concerned

only with commercial banks' dealings in instruments of capital finance, not with their dealings in commercial credit instruments such as commercial paper. Moreover, commercial paper poses none of the specific risks—either to banks themselves or to bank depositors—that the Glass-Steagall Act addresses.

2. The inclusion of some forms of commercial paper within the much broader definition of "security" contained in the Securities Act of 1933 is irrelevant in interpreting the Glass-Steagall Act because these statutes serve markedly different purposes.

ARGUMENT

I.

COMMERCIAL PAPER IS NOT A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT.

Section 21 of the Glass-Steagall Act, 12 U.S.C. § 378 (1982), effectively bars commercial banks from dealing in "stocks, bonds, debentures, notes, or other securities".[2] In petitioners' view, commercial paper obligations, which are short-term, negotiable promissory notes,[3] are necessarily

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[2] Sections 16 and 21 of the Act, 12 U.S.C. §§ 24 (Seventh) and 378 (1982), approach the legislative goal of separating the business of commercial banking from that of investment banking from different directions. Section 16 forbids commercial banks to underwrite "securities or stock", while § 21 forbids underwriters of "stocks, bonds, debentures, notes, or other securities" to accept deposits. As this Court has recognized, "§ 21 present[s] the converse situation of § 16", *Board of Governors v. Investment Company Institute,* 450 U.S. 46, 63 (1981), and the scope of the provisions is substantially the same, *Investment Company Institute v. Camp,* 401 U.S. 617, 635 (1971).

The inquiry in this litigation as to whether commercial paper is a statutory "security" has focused on § 21 because it is the more specific provision and is the provision on which petitioners rely.

[3] *See, e.g.,* Hurley, *The Commercial Paper Market,* 63 Fed. Res. Bull. 525, 525 (1977); Comment, *The Commercial Paper Market and the Securities Acts,* 39 U. Chi. L. Rev. 362, 363-64 (1972).

"notes" within the meaning of the Act, and are therefore statutory "securities". (SIA Br. at 12; Becker Br. at 26.) In the financial world with which the Glass-Steagall Act is concerned, however, the term "note" may be used in several distinct senses. It may refer generically to any promissory instrument.[4] It may also be used to refer more specifically either to commercial paper or to a particular instrument of capital finance, hereinafter referred to as an "investment note", that differs radically from commercial paper.[5] The context in which the term is used will determine which of these financial meanings it bears.

The language of § 21 shows on its face that Congress did not intend the term "notes" to have the broad generic meaning, encompassing any promissory instrument, that petitioners espouse. When used in this broad sense, the term encompasses bonds and debentures as well as commercial paper and longer-term "investment" notes. *See, e.g.,* E. Farnsworth & J. Honnold, *Commercial Law* 51 (3d ed. 1976); *Encyclopedic Dictionary of Business Finance* 73 (1960). Because § 21 refers in terms to "bonds" and "debentures" as well as to "notes", the statute would be redundant if the latter term were given its broad generic meaning. Accordingly, analysis of the statutory language must start from the premise that the term "notes" is not all-embracing, but necessarily refers to some *specific type* of promissory obligation.

Where, as here, a statutory term is "capable of many meanings", a reviewing court must carefully scrutinize the language of a statute that employs the term "in order to avoid the giving of unintended breadth to the Acts of Congress".

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[4] *See, e.g.,* G. Munn & F. Garcia, *Encyclopedia of Banking and Finance* 724 (8th ed. 1983) (a "note" is "[a] promise to pay as distinguished from an order to pay, such as a draft or check").

[5] Petitioner Becker describes the term "investment note" as "heretofore unknown" (Becker Br. at 26). It is true that in financial circles such obligations are typically referred to, without qualification, as "notes", as they are in the Glass-Steagall Act. Nonetheless, the term "investment note" is sometimes used. G. Munn & F. Garcia, *supra,* at 127 ("A bond differs from an investment note only in the time which it has to run before maturity").

Jarecki v. G.D. Searle & Co., 367 U.S. 303, 307 (1961). As we show below, the language, the legislative history and the basic purposes of the Glass-Steagall Act combine to demonstrate that Congress used the term "notes" in § 21 to refer to the type of note that is a capital finance instrument, not to commercial paper. This analysis also demonstrates that commercial paper cannot be a "security" within the meaning of the Act.

A. The Term "Note" Has Two Distinct Financial Meanings.

The term "note" is often used in finance to refer to a specific type of long-term debt security, herein referred to as an "investment note", that closely resembles a bond or debenture but is of shorter maturity. *See, e.g.,* 1 A. Dewing, *The Financial Policy of Corporations* 178 (5th ed. 1953); H. Lyon, *Corporations and Their Financing* 227 (1938); E. Mead, *Corporation Finance* 301 (rev. ed. 1919) (A14)[6]; N. Moore, *Dictionary of Business Finance and Investment* 292 (1975); G. Munn & F. Garcia, *supra,* at 127. The financial functions, investment characteristics, and other distinguishing features of such investment notes differ sharply from those of commercial paper.

Bonds, debentures, and investment notes serve similar financial functions. Specifically, they enable the corporation issuing them to borrow money over an extended period of time for use as part of its "permanent" capital structure. *E.g.,* H. Lyon, *supra,* at 219-24, 226-27; H. Moulton, *The Financial Organization of Society* 107, 111-18, 165 (2d ed. 1925) (A16, A17-A21, A22). The chief difference between investment notes

[6] Throughout this section of the brief, an effort has been made to cite both recent authorities and authorities roughly contemporary with, or older than, the Glass-Steagall Act, the purpose being of course to show that the usages under discussion were current when the Act was passed.

For the Court's convenience, cited portions of some of the older authorities are reproduced in Appendix A hereto. Citations to authorities so reproduced are followed by the notation "(A)", indicating the page of the Appendix at which the cited passage appears.

and bonds or debentures is one of maturity. Whereas bonds and debentures typically mature in a period of 15 or 20 years or more, investment notes typically mature a few years after issuance, *e.g.*, 1 A. Dewing, *supra*, at 178; E. Mead, *supra*, at 301 (A14); G. Munn & F. Garcia, *supra*, at 127. Investment notes are often used in lieu of bonds or debentures to secure long-term financing at a time when conditions do not favor issuance of very long-term securities, as when interest rates are high or future business conditions uncertain; they satisfy the issuer's capital needs until conditions become more favorable for a longer-term issue. *E.g.*, E. Mead, *supra*, at 301 (A14); H. Moulton, *supra*, at 113-18 (A19-A21).

Bonds, debentures, and investment notes are also closely related from the investor's point of view. An investor's decision to purchase any of these securities reflects his assessment of the rewards and risks of owning a security that will not mature until the relatively distant future. Because the capital finance markets are capable of accommodating issuers of widely varying degrees of financial strength, yields will vary considerably among issuers,[7] and some issues will be relatively speculative, compensating the holder for his greater risk with a correspondingly greater return. In addition, because such securities are often purchased at a discount from or premium over their face values, the prospect of long-term capital gains or losses will often affect the calculation of total return. Moreover, the investor may realize capital gains or losses on a bond, debenture, or investment note before maturity if he sells it in the secondary markets which exist for such securities. Finally, the purchaser of such a security assumes not only the credit risks associated with the issuer's financial strength, but also the market risks inherent in any capital investment, for changing market conditions may cause the investment to decline in value or become illiquid, regardless of the issuer's strength.

Commercial paper, while consisting of promissory "notes", is different in every relevant respect from capital finance instruments such as investment notes.

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[7] *See* Appendix B, which reproduces from *The Wall Street Journal* sample "tombstone" notices for several new issues of investment notes.

Corporations usually issue commercial paper to obtain short-term credit to finance current transactions or for current cash requirements, not to obtain capital funds for long-term projects. *E.g.*, N. Baxter, *The Commercial Paper Market* 59, 62-63, 75 (1966); R. Foulke, *The Commercial Paper Market* 4-5 (A3-A4)(1931). Some firms issue commercial paper to meet seasonal needs, while others issue such paper throughout the year in response to fairly continuous short-term needs. *E.g.*, N. Baxter, *supra*, at 32-33, 62-63; A. Greef, *The Commercial Paper House in the United States* 249-50 (1938); Hurley, *supra*, 63 Fed. Res. Bull. at 526-27. In either case, commercial paper serves as an alternative to bank loans as a source of short-term financing. *E.g.*, N. Baxter, *supra*, at 10-12, 59-66; A. Greef, *supra*, at 249; Hurley, *supra*, 63 Fed. Res. Bull. at 525. Reflecting this role of commercial paper as a means of interim financing, commercial paper maturities are very brief; in the 1930's, they averaged from four to six months, *e.g.*, A. Greef, *supra*, at 231, while now they typically range from 30 to 90 days and do not exceed 270 days, *e.g.*, N. Baxter, *supra*, at 30; Hurley, *supra*, 63 Fed. Res. Bull. at 530; *see also* Securities Act of 1933, § 3(a)(3), 15 U.S.C. § 77c(a)(3) (1982). Commercial paper is thus similar in nature to other commercial credit instruments, such as bankers' acceptances and certificates of deposit, that have never been viewed as "securities" under the Glass-Steagall Act.

For the buyer as well as the issuer, commercial paper performs functions very different from those of capital finance instruments such as investment notes. For the buyer, commercial paper is not a long-term investment, but is simply a convenient means of obtaining a return on temporarily idle funds, *e.g.*, N. Baxter, *supra*, at 23, 81-83, 91-96; A. Greef, *supra*, at 307, 324. The buyer tailors the amounts and maturities of the commercial paper it purchases to reflect its projected near-term needs for cash. *E.g.*, N. Baxter, *supra*, at 82, 100-03; A. Greef, *supra*, at 233, 324. Commercial paper is not purchased by the general public, but by institutions and, occasionally, by those few individuals who have very substantial sums available for short-term lending. *E.g.*, N. Baxter,

supra, at 29, 39-41; A. Greef, *supra,* at 292-306; Hurley, *supra,* 63 Fed. Res. Bull. at 525, 529. Because the commercial paper market is ordinarily accessible only to firms of prime financial capacity, *e.g.,* R. Foulke, *supra,* at 30-31 (A5-A6); A. Greef, *supra,* at 235; Hurley, *supra,* 63 Fed. Res. Bull. at 527-29, the rate of return on such paper primarily reflects prevailing money market rates, with risk premiums playing a relatively insignificant role, *e.g.,* A. Greef, *supra,* at 319-20, 372; Hurley, *supra,* 63 Fed. Res. Bull. at 530-31. Commercial paper is not a vehicle for capital appreciation or for any form of speculation. Its brief maturity precludes the possibility of long-term capital gains, and there are no organized secondary markets in which speculative profits might be taken, *e.g.,* N. Baxter, *supra,* at 109-18; Hurley, *supra,* 63 Fed. Res. Bull. at 529.[8] Unlike capital finance instruments, commercial paper is not subject to market risk, in that its value does not fluctuate in response to market pressures, *e.g.,* R. Foulke, *supra,* at 92 (A8), and it is subject only to slight credit risk, for it is issued only for short periods and only by strong issuers, A. Greef, *supra,* at 316. *See also* N. Baxter, *supra,* at 26; A. Greef, *supra,* at 307-08; Hurley, *supra,* 63 Fed. Res. Bull. at 532-33.

In short, investment notes and commercial paper are "notes" of very different species.[9] As we show below, the Glass-Steagall Act applies only to investment notes and has no bearing on commercial paper.

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[8] Most purchasers of commercial paper hold it to maturity, and the secondary market, to the limited extent one exists, involves occasional repurchases of paper by dealers from their customers. M. Stigum, *The Money Market* 640-41 (rev. ed. 1983).

[9] Investment notes differ from commercial paper in several respects in addition to those discussed above. For example, investment notes, like other debt securities, traditionally pay interest at a fixed rate and at stated intervals, usually semiannually. *E.g.,* 1 A. Dewing, *supra,* at 171, 180-183; G. Munn & F. Garcia, *supra,* at 126-27. Commercial paper often does not promise in terms to pay interest, its holder receiving a return only through discounting. *E.g.,* N. Baxter, *supra,* at 28; R. Foulke, *supra,* at 91 (A7). When offered to the public, investment notes must be governed by a trust indenture, a comprehensive agreement between the issuer and a trustee that specifies the respective rights, powers, and obligations of noteholder

B. The Language of the Glass-Steagall Act Demonstrates That Commercial Paper Is Neither a "Note" Nor a "Security" Within the Meaning of the Act.

Section 21 of the Glass-Steagall Act bars the business of deposit banking to underwriters of "stocks, bonds, debentures, notes, or other securities". The first three items in the list, stocks, bonds, and debentures, are instruments used to obtain long-term capital financing. Ordinarily, therefore, one would expect the next item in the list to be another instrument of long-term capital finance that is significant enough to warrant separate mention. *See, e.g., Jarecki v. G.D. Searle & Co., supra,* 367 U.S. at 307 (statutory term "gathers meaning from the words around it"). The only logical choice for this next place in the statutory list is the investment note, an instrument that, as shown above, closely resembles a bond or debenture in function and is sufficiently important in finance to require separate mention, lest the statutory prohibition be evaded.

Commercial paper could not logically fill this place in the list, for it is a form of obligation with purposes and characteristics very different from those of the other items. Unlike stocks, bonds, and debentures, commercial paper does not form any part of a corporation's permanent capital structure, it is not held for long-term return, it is not actively traded in secondary markets, and its lifespan is measured in months or days, not

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and issuer. *See* Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1982); 1 A. Dewing, *supra,* at 171-75, 176-83. Commercial paper is rarely issued pursuant to a trust indenture, but bears its contract, a simple obligation to pay, upon its face. *E.g.,* N. Baxter, *supra,* at 28; A. Greef, *supra,* at 223. Because investment notes typically represent complex agreements between issuer and holder, they are usually elaborate, formal instruments, often under seal. *E.g.,* H. Lyon, *supra,* at 227; G. Munn & F. Garcia, *supra,* at 126-27. Commercial paper instruments are generally very simple in form. *E.g.,* N. Baxter, *supra,* at 28; A. Greef, *supra,* at 222-29. *See also* R. Foulke, *supra,* at 150-52 (A10-12). Finally, because commercial paper is an essentially simple instrument, issued only in large denominations to a comparatively small number of purchasers, it entails transaction costs significantly smaller than those of an underwriting of securities.

years or decades.[10] Moreover, given the context supplied by § 21, which naturally suggests capital finance instruments, it is difficult to suppose that Congress intended to use the term "notes" in a peculiar dual sense encompassing both commercial paper and investment notes. The term is not ordinarily used in such a double sense, and it would stretch credulity to suppose that Congress, in drafting a statute specifically addressed to the financial community, would have assigned to a familiar financial term a distinctive meaning that is actually concealed by the context.[11]

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[10] Petitioners make much of the fact that instruments denominated bonds and debentures sometimes have brief maturities. *See* Becker Br. at 38 n.65 and Supp. App.; SIA Br. at 16. While such anomalies do exist, the fact remains that the vast majority of bonds and debentures are long-term instruments that mature 15 or 20 years or more after issuance. *See* pp. 7-8, *supra.* Indeed, several of the specific issues of securities cited in Becker's Supplemental Appendix are denominated "certificates of indebtedness", not "bonds" or "debentures" (Becker Br. S2, S3, S7). Most of the others are serial issues, in which portions of the issue are redeemed at different times, sometimes commencing shortly after issuance, but the issue as a whole is not retired for a number of years (*id.* S4, S6, S9, S10, S12, S13, S15).

In similar manner, petitioners attempt to confuse the issue by pointing to the fact that some commercial paper issuers "roll over" their outstanding obligations on a regular basis, thus employing short-term funds for longer-term purposes. (Becker Br. at 27 n.40; SIA Br. at 16.) Whether or not the issuer seeks to "roll over" the debt, commercial paper remains short-term in character. The purchaser is entitled to redeem the paper according to its tenor at maturity, and the issuer must either pay or refinance its obligations as they fall due.

[11] *See* 2 F. Horack, *Sutherland's Statutes and Statutory Construction* § 4919, at 441-42 (3d ed. 1943) ("Statutes dealing with trade and commerce are intended for practical use and application by men engaged in trade and commerce. . . . [I]n the absence of a legislative intent to the contrary, commercial terms when used in a statute relating to trade or commerce are presumed to have been used in their trade or commercial meaning") (footnotes omitted). *See also Corning Glass Works v. Brennan,* 417 U.S. 188, 201 (1974) ("where Congress has used technical words or terms of art, 'it [is] proper to explain them by reference to the art or science to which they [are] appropriate'") (quoting *Greenleaf v. Goodrich,* 101 U.S. 278, 284 (1880)); *id.* at 202 (courts should accept definitions employed "across a wide range of American industry"); *NLRB v. Coca-Cola Bottling Co.,* 350 U.S. 264, 269 (1956) ("if the word be deemed to have a peculiar connotation for those intimate with [the field to which it pertains], it is incumbent upon [the court] to give the word its technical meaning").

Analysis of the statutory language also refutes the proposition that commercial paper is somehow a "security" within the Act even if it is not a "note". Ordinarily, "where general words follow an enumeration of specific items [in a statute], the general words are read as applying only to other items akin to those specifically enumerated". *Harrison v. PPG Industries, Inc.*, 446 U.S. 578, 588 (1980). Thus, the concluding phrase of § 21—"or other securities"—would ordinarily refer to financial instruments "akin" to those specifically mentioned. Because commercial paper differs radically in character and function from the instruments of capital finance specifically mentioned in the Act, it cannot reasonably be read into the Act as a "security".[12]

An examination of the purposes of the Glass-Steagall Act, as reflected in its legislative history, confirms the straightforward reading of its language presented above.

C. Excluding Commercial Paper from Coverage as a "Security" Under the Glass-Steagall Act Is Consistent with the Purposes of the Act.

Congress's concerns in drafting the Glass-Steagall Act were twofold. First, the legislators believed that extensive commercial bank participation in the capital finance markets created certain risks which adversely affected the commercial banking industry and, ultimately, the national economy. *See* pp. 13-15, *infra*. Second, they believed that the promotional pressures of investment banking could sometimes lead commercial bankers to depart from sound banking practices, thus jeopardizing bank deposits. *See* pp. 16-18, *infra*. As we show below, excluding commercial paper from coverage under the

[12] Pointing to the other references to "notes" in the federal banking laws in which Congress employed a qualifying adjective to describe the particular type of note intended, petitioner Becker asserts that the absence of such explicit qualification in § 21 of the Glass-Steagall Act indicates a congressional intent to use the term in a sense broad enough to encompass commercial paper. *See* Becker Br. at 27-28. In § 21, however, such explicit qualification was unnecessary, for it is apparent from the context that only notes having an investment character like that of stocks, bonds and debentures were intended.

Act as a "security" fully comports with the economic objectives of the statute. As we also show, commercial paper does not threaten the safety of bank deposits.

1. *The Economic Objectives of the Act.* One fundamental objective of the Glass-Steagall Act was to strengthen the operation of commercial banks in the commercial credit markets, one of their traditional domains, by limiting their exposure to risks associated with the capital finance markets, the traditional domain of investment bankers. *See, e.g., Board of Governors of the Federal Reserve System v. Investment Company Institute,* 450 U.S. 46, 61-62 (1981); *Investment Company Institute v. Camp,* 401 U.S. 617, 629 (1971); Perkins, *The Divorce of Commercial and Investment Banking: A History,* 88 Banking L.J. 483 (1971). Specifically, Congress limited the power of banks to underwrite certain capital finance instruments, to purchase them for their own accounts, and to loan money for the purpose of purchasing them. *See* Banking Act of 1933, §§ 3(a), 5(c), 9, 11(a), 16, 19(e), 20, 21, 32 (codified at scattered sections of 12 U.S.C.). Congress believed that the propensity to have bank assets "tied up" in extensive holdings of such instruments rendered banks illiquid and unduly subjected them to the market risks inherent in such investments. *See, e.g.,* S. Rep. No. 77, 73d Cong., 1st Sess., 6-7, 8-10 (1933); 76 Cong. Rec. 1405 (1933) (remarks of Sen. Glass). Congress also believed that widespread commercial bank involvement in purchases of such instruments fueled excessive speculation, thus disrupting those markets and harming all participants in them. *See, e.g.,* S. Rep. No. 77, *supra,* at 3-4, 5-7, 8-10; 75 Cong. Rec. 9904 (1932) (remarks of Sen. Walcott); 75 Cong. Rec. 9911-12 (1932) (remarks of Sen. Bulkley). The Act therefore sought to curb the powers that had permitted commercial banks to invest in the capital finance markets resources which Congress thought were better committed to other areas, particularly the commercial credit markets. *See generally Board of Governors v. Investment Company Institute, supra,* 450 U.S. at 61-62; Perkins, *supra,* 88 Banking L.J. at 497-505; U.S. Dep't of the Treasury, *Public Policy Aspects of Bank Securities Activities* app. 12-15, 17-18 (1975) (hereinafter cited as "*Public Policy*"). *See also* 75 Cong. Rec. 9909 (1932) (remarks of Sen.

Bulkley) (Act limits commercial bank operations "in the long-term capital market").[13]

The only reading of the disputed phrase "notes, or other securities" that is consistent with this economic objective is one which includes within the statutory prohibition such capital finance instruments as investment notes and excludes such instruments as commercial paper. First and most fundamentally, commercial paper is a commercial credit instrument that has nothing to do with capital finance. A commercial paper transaction takes place not in the capital finance markets, *i.e.*, the securities markets, but squarely within the commercial credit markets, *i.e.*, the money markets, in which the Glass-Steagall Act sought to strengthen commercial bank operations. Thus, when participating in a commercial paper transaction, a commercial bank does not divert its resources from this traditional sphere of bank activity, but in fact retains them there.[14]

Second, and precisely because commercial paper is associated with commercial credit rather than capital finance, commercial paper transactions create none of the specific economic risks at which the Act takes aim. Commercial paper does not entail extended exposure of bank assets to market fluctuations,

[13] The Act does not wholly bar commercial banks from participating in capital market transactions. For example, they may buy and sell "securities" for their customers' accounts, may buy and sell certain "investment securities" for their own accounts, and may underwrite and deal in a wide variety of government securities. *See* 12 U.S.C. § 24 (Seventh) (1982). The principal problem, in the view of the Glass-Steagall Congress, was the degree of commercial bank involvement in relatively speculative issues, which placed bank assets at risk. *See, e.g.*, S. Rep. No. 77, *supra*, at 3-4, 6-7, 8-10. *See also* Banking Act of 1933, ch. 89, preamble, 48 Stat. 162 (statute intended "to prevent the undue diversion of funds into speculative operations").

[14] In fact, commentators have noted that investment banks that participate in commercial paper transactions are performing the traditional lending functions of commercial banks, rather than their own traditional function of facilitating long-term capital financing. *See* R. Foulke, *supra*, at 134 (A9); A. Greef, *supra*, at 379.

it does not "tie up" those assets for extended periods of time, and it is not a vehicle for speculation. As to the credit risks of commercial paper, commercial banks have traditionally assumed them not only by purchasing such paper, but also by maintaining lines of credit upon which commercial paper issuers may draw in order to redeem their paper at maturity if financial reverses or other circumstances prevent them from doing so with other funds. *See, e.g.*, N. Baxter, *supra*, at 55, 66-69. Although purchasing commercial paper or backing it with a line of credit necessarily subjects the lender to the credit risks of commercial paper, no one has suggested that such activity contravenes the Glass-Steagall Act. This is so because the risks associated with commercial paper are slight and are in any event commercial credit risks of the sort that commercial banks traditionally take, and against which banks protect themselves through credit analysis and diversification.[15]

In sum, commercial bank involvement with commercial paper is fully consistent with the economic objectives of the Glass-Steagall Act. For this reason alone, commercial paper should be excluded from coverage under the Act as a "security". Moreover, as we show below, the Act's concern for depositor protection does not justify an interpretation of its language more sweeping than that dictated by its economic goals.

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[15] Of course, losses can occur, and on a very few occasions have occurred, in commercial paper transactions. *See, e.g.*, Hurley, *supra*, 63 Fed. Res. Bull. at 532-33 and 536 n.12 (3 defaults in period 1946-1970). Nonetheless, the petitioners' concern for the economic well-being of the commercial banking industry is misdirected. Every banking activity entails some risk of loss. But in fact, the degree of risk associated with commercial paper is significantly less than that associated with traditional lending activities. *E.g.*, A. Greef, *supra*, at 307-08, 311-14.

2. *Depositor Protection.* In addition to the economic goals discussed above, the Glass-Steagall Act sought to protect commercial bank depositors from certain abuses that Congress associated with commercial bankers' activities in the securities markets. Specifically, Congress believed that a commercial bank might imprudently recommend securities owned or underwritten by it to its depositors. In addition, Congress feared that commercial banks might imprudently loan money to depositors to facilitate the purchase of such securities or to issuers of such securities who become financially embarrassed. The possibility of such imprudent sales and lending activities was thought to jeopardize the safety of bank deposits. Accordingly, a second purpose of the Glass-Steagall Act's prohibition against the underwriting of "securities" by commercial banks was to relieve commercial bankers from the promotional pressures associated with investment banking. *See generally Investment Company Institute v. Camp, supra,* 401 U.S. at 629-34 (reviewing legislative history); *Public Policy, supra,* app. at 18-21.

The commercial paper activities at issue in this litigation do not pose a credible threat to the safety of bank deposits. Unlike capital investment vehicles, commercial paper does not expose the holder to market risk, and it is rarely purchased by individuals. A bank engaged in commercial paper placements would therefore have little opportunity to foist worthless paper upon unsuspecting depositors, even in the unlikely event that it were inclined to do so. Moreover, the possibility that a placing bank might imprudently loan money for commercial paper purchases is virtually nil: almost by definition, commercial paper is purchased with the buyer's free cash reserves, not with borrowed money, and in any event the rate of return on commercial paper is usually lower than the interest rate charged on bank loans, *see, e.g.,* N. Baxter, *supra,* at 74 and n.9; A. Greef, *supra,* at 320, so that such transactions would be uneconomical and therefore exceedingly rare. In addition, because commercial paper issuers generally have prime financial capacity and arrange standby credit facilities for redeeming their paper before they issue it, the likelihood that a placing bank might be tempted to "bail out" an embarrassed issuer

with imprudent loans is minimal.[16] Thus, the Act's concern with depositor protection has little or no relevance to commercial paper.

Furthermore, to the extent that these concerns might conceivably bear upon commercial paper, the Board has dealt with them in its guidelines, *see* Board of Governors of the Federal Reserve System, *Policy Statement Concerning the Sale of Third Party Commercial Paper by State Member Banks,* 46 Fed. Reg. 29,333 (1981) (hereinafter cited as "*Policy Statement*"). These guidelines merely reiterate and reinforce the realities of the commercial paper market that make commercial paper an extremely unlikely vehicle for depositor abuse. They eliminate the already slight possibility that worthless paper might be "unloaded" upon the unwary by limiting placements to paper of "prime" quality and by forbidding placement of paper with the placing bank's trust accounts, with its nonbank affiliates, or, in general, with any financially unsophisticated buyer.[17] *Id.* at 29,334-35. In addition, the guidelines correctly recognize that the interest rate differential between direct bank loans and commercial paper precludes the possibility of imprudent lending to finance paper purchases. *Id.* at 29,334. The limitation of placements to prime quality paper minimizes the possibility of unsound lending to financially troubled issuers. Moreover, the guidelines further diminish this possibility by

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[16] Extensive regulation of commercial bank lending policies for their safety and soundness, *see, e.g.,* 12 U.S.C. § 1818(b) (1982), further diminishes this already slight possibility of unsound loans to issuers.

[17] Moreover, under the guidelines banks may not advertise paper to the general public and may not place it in denominations of less than $100,000. *Policy Statement, supra,* 46 Fed. Reg. at 29,334. These restrictions further ensure that paper will be placed only with buyers who are capable of appraising the issuer's creditworthiness independently. Significantly, these restrictions merely reflect standard practices that have prevailed in the commercial paper market for many years. Historically, dealers have not offered paper to the general public, *see, e.g.,* A. Greef, *supra,* at 326-28, and the large minimum denomination of dealer paper has precluded purchases by most individuals, *see, e.g.,* Hurley, *supra,* 63 Fed. Res. Bull. at 528.

requiring careful review of an issuer's financial condition, and by requiring senior management of the placing bank to establish internal limits for paper placements that reflect both the issuer's financial condition and the placing bank's commitments, if any, to extend credit to the issuer. *Id.*

This Court has recognized, in a related context, that such an effective scheme of regulation can indeed alleviate concerns which might otherwise require an expansive classification of a particular financial instrument as a "security" for statutory purposes. *See Marine Bank v. Weaver,* 455 U.S. 551, 558 (1982). Because the Board's guidelines adequately address the Glass-Steagall Act's concern for depositor protection, they would effectively remove that concern from this case even if it were relevant to commercial paper—which it is not.[18] Accordingly, principles of depositor protection cannot justify including commercial paper—an instrument wholly irrelevant to the economic objectives of the Act—within the Glass-Steagall Act as a "security".

II.

THE DEFINITION OF "SECURITY" CONTAINED IN THE SECURITIES ACT OF 1933 REFLECTS THE BROAD PURPOSES OF THAT ACT AND IS IRRELEVANT IN DETERMINING WHETHER COMMERCIAL PAPER IS A "SECURITY" WITHIN THE MEANING OF THE GLASS-STEAGALL ACT.

Section 2(1) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77b(1) (1982), like the definitional provisions of other later-enacted securities laws, defines the term

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[18] The Board's decision to promulgate the guidelines does not indicate that commercial paper poses a sufficient risk to bank deposits to warrant its classification as a "security". The guidelines themselves merely ensure that banks' authority to place commercial paper will not be transmuted by gradual changes in practice. The Board viewed such a risk as remote. *See Policy Statement, supra,* 46 Fed. Reg. at 29,333 ("certain practices *may* develop . . . that *may* not be consistent with" sound banking principles) (emphasis added). Moreover, because the guidelines for the most part reiterate standard industry practice, they are actually predicated upon the fact that commercial bank involvement in commercial paper transactions poses little risk for depositors.

"security" broadly enough to include some forms of commercial paper. *See also id.* §§ 77c(a)(3), 77*l*(2). Petitioners assert that commercial paper is therefore also a "security" within the meaning of the Glass-Steagall Act, which was enacted at about the same time as the 1933 Act. (Becker Br. at 30; SIA Br. at 17-18.) Comparison of the very different purposes of these bodies of legislation demonstrates that this conceptual leap is not justified.

One overriding purpose of the 1933 Act and of other federal securities laws was to protect the public from abuses of fraud and deception that may occur whenever members of the public invest their money in hope of sharing profit opportunities with entrepreneurs. *E.g., SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). To achieve this purpose, Congress defined the term "security" in the 1933 Act with remarkable breadth.[19] The definition applies to a very wide variety of interests in arrangements for common gain, whether the arrangements are speculative or nonspeculative in character, whether the interests involved are valueless apart from the arrangement or have intrinsic value, and regardless of the legal characterizations that might otherwise apply to either the interests or the arrangements concerning them. *E.g., id.* at 300-01. The 1933 Act has been held to encompass not only such traditional investment media as stocks and bonds, but also such comparatively exotic

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[19] As originally enacted, the 1933 Act defined the term "security" as follows:

> "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of interest in property, tangible or intangible, or, in general, any instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing." Securities Act of 1933, ch. 38, tit. I, § 2(1), 48 Stat. 74 (current version at 15 U.S.C. § 77b(1) (1982)).

The definition was amended, and further broadened, by the Securities Exchange Act of 1934, ch. 404, tit. II, § 201(a)(1), 48 Stat. 905.

"securities" as an agreement concerning the breeding of chinchillas, *Miller v. Central Chinchilla Group, Inc.*, 494 F.2d 414 (8th Cir. 1974), and a common pyramid scheme, *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974). Such broad scope is in keeping with the broad statutory purpose of protecting investors from "the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits". *SEC v. W.J. Howey Co., supra,* 328 U.S. at 299.

Reading the broad 1933 Act definition of "security" into the Glass-Steagall Act would stretch the latter Act far beyond its intended bounds. Unlike the 1933 Act, the Glass-Steagall Act does not purport to protect investors who may be enticed by "countless and variable" profit-making schemes; it has the much more specific purpose of protecting bank depositors by limiting the power of commercial banks to place deposits at risk in the capital finance markets. *See* pp. 13-18, *supra.* The language of the Glass-Steagall Act reflects this more specific purpose. While broad enough to achieve its intended purposes, *see Investment Company Institute v. Camp, supra,* 401 U.S at 635, that language refers in terms only to traditional instruments of capital finance, and, unlike the language of the 1933 Act, it does not purport to be all-embracing. The Glass-Steagall Act is not concerned with instruments such as commercial paper that are classically disassociated from capital finance. The status of commercial paper under the 1933 Act and other securities laws is therefore irrelevant in determining whether such paper is a "security" within the meaning of the Glass-Steagall Act.

CONCLUSION

For the reasons stated above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

ROBERT S. RIFKIND
STEPHEN S. MADSEN
ELIZABETH S. STONG
One Chase Manhattan Plaza,
New York, N.Y. 10005

Attorneys for The New York Clearing House Association and The American Bankers Association as Amici Curiae

CRAVATH, SWAINE & MOORE,
One Chase Manhattan Plaza,
New York, N.Y. 10005

DEBORAH S. PRUTZMAN,
General Counsel,
The New York Clearing House Association,
100 Broad Street,
New York, N.Y. 10004

WILLIAM H. SMITH,
General Counsel and Secretary,
MICHAEL F. CROTTY,
Assistant General Counsel—Litigation,
American Bankers Association,
1120 Connecticut Avenue, N.W.,
Washington, D.C. 20036

Of Counsel.

APPENDIX A

A-2

THE COMMERCIAL PAPER MARKET

By

ROY A. FOULKE

NEW YORK
The Bankers Publishing Company

[1931]

and industrial lines of business, which offer notes through commercial paper brokers, to turn over their merchandise and thus make their notes self-liquidating.

In the broader economic sense and in its legal interpretation, the term "commercial paper" covers a much wider field, including all classes of short term negotiable instruments. Judge Withey in Re Nichodemus rendered the decision that the term denotes "bills of exchange, promissory notes, and negotiable bank checks,"[2] while Judge Blodgett in Re Sykes writes that the phrase "commercial paper" means "negotiable paper, that is, promissory notes or bills of exchange made by a banker, merchant or trader in the due course of his business."[3]

In the early days of the Federal Reserve System, the late Ralph Van Vechten, well known for his constructive vision in bank credit work, defined commercial paper as follows:

> Commercial paper consists of promissory notes, bills of exchange or acceptances in negotiable form representing advances to be used in the production, manufacture, distribution, or storage of commodities for which there is a constant, periodic or seasonal demand by the con-

[2] Decision rendered in U. S. District Court, E. D. Michigan, 1869. Re Nichodemus (U. S.) 18 Fed. Cas. 222-224.

[3] Decision rendered in U. S. District Court, N. D. Illinois, March 1870. Re Sykes, 23 Fed. Cas. 582-584.

sumers, merchants or manufacturers so that in the natural course of events the satisfying of this demand with a reasonable lapse of time from date of issuance of the paper will result in the payment of the notes, bills of exchange or acceptances thus created. For illustration, under this definition the financing of bricks in the process of manufacture would be proper, but the financing of a building in which these bricks are used in construction would not.[4]

While the interpretation we have given to the term "commercial paper" is restricted to the very definite field of short term credit obligations generally sold to banking institutions which do not have the deposit accounts of the concerns seeking credit, the meaning is a clear one and an accepted one in present-day American banking practice.

As the use and advantage of the open market have become more widely known, mercantile concerns in the South and the West have obtained credit from banks and trust companies a thousand or two thousand miles away in the North and the East and commercial paper has come to take on this more definite, restricted meaning. Commercial paper to a banker today has reference not to his loans and discounts, but to his investments in short term notes generally purchased from commercial paper brokers.

[4] Quoted by O. H. Wolfe, in *Practical Banking*, published by the LaSalle Extension University, Chicago, 1918. p. 99.

conditions, when the open market rate is as low or even lower than the discount rate of its own banks, it may sell its paper to the extent of its entire credit requirements. In this situation, it pays off its banks entirely, but still continues to maintain its usual bank balances. The cost of keeping such large bank balances, whether borrowing from its own banks or not, is considered in the nature of an insurance premium. It gives the company a call at all times on $25,000,000 of bank accommodation. No money stringency can ever jeopardize the position of this company so long as its fundamental financial position remains sound.[1]

This example is based on actual figures. In practice, the principle admits of much variation. It may be modified according to the size of the borrower—whether the concern has combined capital and surplus of $325,000 or $325,000,000—according to the nature and location of the business, and according to the nature of its credit needs.

The Open Market as a Credit Guide

The credit standing of a concern which sells its notes in the open market is thoroughly investigated and analyzed by six separate, distinct organizations: (1) the note broker who handles the notes, (2) banks which have the account, (3) banking

[1] Address delivered by Walter E. Sachs on "Commercial Paper and Its Place in Our Banking System," August 24, 1921, before the Kentucky Bankers Association.

institutions buying the notes under option, (4) city correspondents of the buying banks, (5) trade creditors and (6) specialized credit organizations.

Any slight question as to the inherent financial soundness of an enterprise offering its notes in the open market immediately comes to light, and the notes fail to sell. It is due to this constant routine of credit investigation and analysis, which is applied so rigorously day after day to every piece of commercial paper sold, that relatively few concerns are able, year in and year out, to keep their financial affairs in such shape that their notes will sell readily at the current market rate of discount.

The result is that any concern which is able to sell its notes in the open market may be considered in that thin, uppermost stratum representing the better risks in our industrial and commercial world. This standing is not due to the qualifying features of general business conditions in the industry, broad market movement, or the rate for money. It is based solely on the financial condition of the concern itself. It is not relative. It is absolute.

Let us see what this thin, uppermost stratum represents.

Industrial Division of Open Market Names

The early open market borrowers in the Nineteenth Century were the New York dry goods commission merchants, concerns which handled the out-

The Face Value of Commercial Paper

The institution of bonds is one of the more fundamental of our modern business institutions, one of the keystones in the archway of our business civilization. Bonds furnish the means for large savings; provide the constant funds by which savings banks pay interest; colleges, universities and endowed museums their annual expenses; and insurance companies their dividends.

Within certain limits, high-grade bonds furnish a sound investment for the surplus funds of commercial banks. The policy of investing in bonds, however, is generally limited by progressive commercial banks to such funds as can be invested permanently, funds which the bank probably will not be called upon to loan to depositors at the peak of the next borrowing season. Surplus funds which are surplus only for from three to six months, which a bank might be called upon to loan to depositors, are generally invested in open market commercial paper, as:

(1) The return is fixed, definite, and assured.

(2) The return is in the form of a discount and not interest.

(3) Commercial paper is rediscountable at each of the twelve Federal Reserve banks.

(4) There is no charge for buying or collecting at maturity.

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(5) The face value of an open market note does not fluctuate.

The face value of a commercial paper note does not fluctuate with general business conditions, the current rate for short term money, or speculative activity on the stock market. Its value, like the monetary value of gold, is fixed, definite, stable. The liquidating value of a bond, on the other hand, fluctuates from day to day and the loss of one point on the principal of a 5 per cent. bond brings the net yield for a year (after deducting the commission for buying and selling) below 4 per cent., and the loss of two points brings it below 3 per cent.

Comparison of the Net Return on Commercial Paper and Wall Street Loans

Under date of February 25, 1926, the members of the New York Clearing House Association passed an amendment to section three, article eleven, of its constitution providing for a charge of not less than 5 per cent. on the interest received upon all collateral loans placed in behalf of correspondents. This amendment became effective March 1, 1926. As a result of instituting this charge, the net return on collateral loans, both time and call loans, placed on Wall Street by out-of-town banking institutions was decreased between one-fifth and one-fourth of 1 per cent.

The return on collateral loans, moreover, is in

(1) in cash upon turning over the notes to the broker, (2) by installments as the broker is able to dispose of the paper, and (3) by a combination of the above two methods whereby the broker makes an initial advance, generally from 80 to 90 per cent. of the face amount of the paper, and remits the balance when the paper is sold.

In the first case the paper is purchased outright at a flat rate, less the broker's charge for handling or "commission," as it is termed, and the borrower receives payment as soon as the notes are delivered. In this case the broker fills a very definite niche in the economic life of our country, acting largely as a retail dealer, his stock-in-trade consisting of commercial paper instead of dry goods, groceries, shoes or hardware. If the rate on the open market should advance before the block of paper is disposed of, the margin of profit decreases and might even disappear; if, on the other hand, the rate should decline, a profit is realized in addition to the regular commission. It is, of course, only the larger brokerage houses with strong financial resources and banking credit which are able to purchase all of their paper outright in this manner.

Theoretically, such operators are more bankers than brokers for they extend short term credit, even though that credit is to be transferred as soon as possible to some other source. Probably the greater volume of paper now placed on the open

condition of his borrower; and (2) he is ready to take paper at a moment's notice for immediate distribution. When open market rates soften a trifle, that is, show a tendency to go lower, the brokers are particularly active in advising their clients of the condition of the money market and the rate at which paper can be sold. At such times they telephone local clients, write letters to out-of-town clients to obtain additional paper, and also address letters to prospective clients. The following is a typical letter sent out by well-known commercial paper brokerage houses at such times:

Gentlemen:

Can you use any four, five or six months' funds to advantage at the present rate? If so, we should be glad to have you advise us. Rates are on a 4½ and 4¾ per cent. basis. Dependent somewhat on the strength of your financial statement, we could place your paper at these rates plus our commission of one-quarter of 1 per cent.

For thirty years we have specialized in commercial paper banking. We supply funds to borrowers located in all sections of the country, many of these concerns having used our facilities over twenty years.

If you are a borrower, we believe that our facilities and our organization can be of service to you. We make outright purchases of our customers' notes at the existing market rate.

Yours very truly,

The Proper Form in Making Open Market Notes

According to current banking practice, eight important points should be kept in mind when notes

are being drawn by a concern to be offered on the open market:

(1.) The denomination of the note, whether $2500, $5000, $10,000 or $25,000, should be specified in the upper left hand corner of the note.

(2.) The location of the borrower, the state and city, followed by the date of the note, should be specified in the upper right hand corner. Notes should never be dated ahead. Occasionally notes are sent to a broker before the time when the funds are desired. In these cases it is better to have the date blank and give the broker the privilege of dating the paper. In these cases the discount is charged, not from the time notes are received, but from the date funds are placed at the disposal of the borrower.

(3.) A specified maturity date such as "August 31, 1928," and not "so many months after date" should be inserted. This practice does away with any possibility of mistakes in the maturity by incorrect calculations from the date; it insures the desired date for payment.

(4.) Notes should be made payable to "ourselves" (maker) and should be endorsed on the back in exactly the same manner as signed on the face of the note. In the case of a corporation, the signature on both the face and the back should bear the full name of the company, signed by an official having authority to do so, that is

The John Doe Company, Inc.
By John A. Doe, President.
By Frank B. Doe, Treasurer.

If the paper also bears a personal endorsement or endorsements, they should appear below the corporation signature on the back of the note. In the case of a partnership, it is necessary for a member of the firm to sign the firm name only on the face and the back, that is, John Doe and Company.

(5.) The amount should be written out fully on the face of the note and not abbreviated.

(6.) If a depository bank is maintained in either New York, Chicago, Boston, Philadelphia or San Francisco, notes should be made payable at this institution. If a concern maintains accounts with banking institutions in several of these cities, the notes are generally made payable at the nearest bank. By far the greater percentage of all paper is made payable at a bank in New York City as New York City is the money center of the country. If no depository account is maintained at a bank in one of these cities, the New York correspondent of a local bank is generally designated.

Early in the Twentieth Century many concerns had their notes made payable at their own office and many at the offices of their brokers. These practices have now entirely disappeared.

(7.) No note should bear an erasure or any alteration. If an error is made in drawing it, a new note should be made out in correct form.

(8.) Notes should be consecutively numbered to assist in identification.

Usually Runs for from Two to Nine Months and Is Self-Liquidating

Commercial paper runs for different lengths of time but by far the greater part placed on the open market has a maturity of six months. Some brokers handle paper with maturities of two months and some even up to twelve months, but only a few concerns borrow on the open market with paper maturing in less than six months and few banking institutions will buy commercial paper with longer

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CORPORATION FINANCE

BY

EDWARD SHERWOOD MEAD, PH.D.

WHARTON SCHOOL OF FINANCE AND COMMERCE,
UNIVERSITY OF PENNSYLVANIA
AUTHOR OF "TRUST FINANCE"

REVISED EDITION

NEW YORK AND LONDON
D. APPLETON AND COMPANY
1919

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Bank loans are not available as a source of permanent capital, although they may furnish a portion of the capital which a corporation requires. In some cases, however, a special form of obligation, either secured or unsecured, is favored by corporations, and largely sold to banks as well as to investors. This is known as the short term note. Such obligations run for one, two, or three years, and pay a high rate of interest—five or six per cent. This form of obligation is usually resorted to during periods of stringency in the money market, when long term bonds cannot be sold except on the basis of a high interest yield.

A first-class railroad corporation expects, under normal conditions of demand, to sell its first mortgage four per cent bonds at par. The money market may, however, get into such a condition that a four per cent bond of this class cannot be sold except at a price to yield five per cent to the investor. Suppose the corporation wishes to issue a thirty year bond. If it makes the issue at such a time, it will have to pay the one per cent extra for thirty years, or thirty per cent on the entire amount of the issue. Looking at the proposition solely from the standpoint of income, and assuming that an improvement in the bond market will, within two or three years, make it possible to again sell four per cent bonds at par, it is advantageous for a company, in the circumstances described, to borrow the amount required for, say, three years, paying six or seven per cent interest, and trusting to its ability to refund the obligation at maturity on a four per cent basis. Instead of paying thirty per cent premium, therefore, the company which makes an issue of two year six per cent notes, and refunds these on a four per cent basis, will only pay four per cent premium for the money over the entire period.

The conditions under which the issue of short term notes is advantageous are illustrated by the situation of the American money market in 1906. During this year, the bond market had been extremely dull. Prices generally declined; issues yielding less than four and a half per cent gained

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THE FINANCIAL ORGANIZATION OF SOCIETY

BY

HAROLD G. MOULTON

DIRECTOR OF THE INSTITUTE OF ECONOMICS
WASHINGTON, D.C.

SECOND EDITION

[1925]

THE UNIVERSITY OF CHICAGO PRESS
CHICAGO, ILLINOIS

CHAPTER VIII

CREDIT INSTRUMENTS

The borrowing or credit operations of modern society are evidenced by written documents, drawn up in legal form, and known as credit instruments. As has already been noted, the term "credit" is often loosely employed in such a way as to give the impression that credit is a form of currency. It is not credit, however, that is used as a form of currency; it is rather the instruments which are the written evidences of antecedent credit operations that serve as media of exchange. In the present chapter we shall consider the various types of credit instruments which are employed in modern credit operations and discuss the development of certain legal principles which have made possible the effective use of these instruments in transferring the ownership of wealth.

As is indicated in the diagrams on pages 163 and 165, the capital of modern businesses is usually divided into two classes fixed and working. The financial instruments that are used in evidencing the loans made in the raising of fixed capital are usually called "investment credit instruments"; while those evidencing borrowed working capital are known as "commercial credit instruments." We shall consider the various types of instruments that fall within each class.

I. INVESTMENT CREDIT INSTRUMENTS

The three principal types of investment credit instruments are bonds, stock certificates, or shares, and short-term notes. An explanation is perhaps necessary for designating a share of stock as a credit instrument; for from a certain point of view a shareholder is legally not a creditor of the corporation but a joint owner in the enterprise. He receives income from his

so likely to mislead the innocent investor, who somehow will persist in believing that a stock whose par value is $100 will ultimately be worth $100, even though its temporary market price may be below that figure; hence he may pay for it more than its real worth. From the viewpoint of the corporation the issue of stock without par value is also a means whereby opposition to overcapitalization may in a measure be circumvented.

Stockholders' "rights" are an interesting but little-known form of credit instrument.—Stockholders' "rights" have arisen out of the exigencies of corporate financing. For instance, when the existing stock of a corporation is selling at, say, 105, additional capital can easily be raised by offering for sale new shares at par, or slightly above. But if additional shares are to be offered for sale at a bargain, it is only equitable that the existing stockholders should be given the first chance to subscribe for the new issue, because the increased capitalization may well affect the value of outstanding shares. Accordingly, it is the usual practice to allow existing shareholders to subscribe for the new issue in proportion to the amount of their holdings; indeed, in many jurisdictions the stockholders have a legal right to subscribe for new stock at par.

Such stockholders' privileges are known as "rights," and they are issued to shareholders in the form of transferable instruments. Upon the receipt of one of these instruments, the shareholder may either avail himself of the opportunity to purchase stock at par, or whatever the figure mentioned, or he may sell his right to another. These rights are in fact bought and sold on the stock exchanges in the same manner as bonds and shares. The market value of a shareholder's right is roughly equal to the estimated difference between the issue price of the new stock of the corporation and its prospective market price.

There are numerous types of bonds.—The terminology employed in describing the many different types of bonds that are in use nowadays is quite baffling to the layman. For in-

stance, a certain bond is described as follows: a 5 per cent railroad collateral trust, refunding, registered, coupon, gold bond. The whole matter may be greatly simplified by classifying bonds from certain points of view as follows: (1) the nature of the issuing corporation; (2) the purpose of the issue; (3) the conditions governing the payment of interest or principal; and (4) the character of the security.

The most important subclasses[1] under each of these headings are as follows:

1. The nature of the issuing corporation

a) Government bonds—national, state, territorial, county, city, township, school district, etc.

b) Corporation bonds—transportation, public utility, industrial, reclamation, real estate, timber, etc.

2. The purpose of the issue

a) Construction bonds

b) Improvement bonds

c) Refunding bonds

d) Equipment bonds

3. The conditions governing the payment of interest or principal. (Classification here is dependent upon the legal provisions governing payment of principal and interest.)

a) Participating bonds

b) Profit-sharing bonds

c) Registered coupon bonds

d) Gold bonds

e) Premium bonds

f) Serial bonds

g) Callable bonds

h) Convertible bonds

[1] Only the main subdivisions in each case are given. For a full classification the reader is referred to Lawrence Chamberlain, *The Principles of Bond Investment* (Henry Holt & Co.), chaps. viii to xi, inclusive. The kind of individual securities that might be listed under the various subclasses are legion.

4. The character of the security
a) First mortgage
b) Second mortgage
c) Collateral trust
d) Debenture

In the case of a first-mortgage bond the bondholders have a prior claim against income, and against property in case interest on the bonds is not paid. The mortgage pledges the property owned by the corporation as a security for the payment of interest and principal. Since it is obviously impossible to give each bondholder a share of the mortgage, the mortgage is placed in trust, and in the event of failure to pay interest the bondholders as a group may foreclose under the terms of the agreement and take possession of the property.

As the name indicates, a second mortgage constitutes a secondary claim against income and property. Anything left after payments have been made to the owners of the first mortgage may be devoted to meeting the claims of the second-mortgage holders.

A collateral trust bond is one which is secured, not by real estate or other physical property owned by the corporation, but by stock or bonds of other companies owned by the issuing corporation. This type of security is mainly found in connection with railroad companies. The term "trust" indicates that these collateral securities are placed in trust with a trust company or other trustee. In the event that interest is not paid on such bonds, the holder may seize the collateral which is held in trust.

A debenture bond proper has no mortgage security but merely a claim against the income of the corporation—a claim, moreover, that is secondary to that of any outstanding mortgage bonds. Its claim against net earnings, however, is prior to that of preferred stock.

The short-term note is frequently employed in raising fixed capital.—The designation "short term" is employed because the

[Pages 114-17, which reproduce specimens of stock and bond certificates, are omitted.]

notes in question usually run from one to five years rather than for long periods, as is the case with bonds. These notes are usually secured only by the income of the company. Accordingly it is customary for payments on the principal to be made serially, that is, a certain percentage of the total debt is paid back annually, thus gradually increasing the security back of the loan.

Short-term notes are usually issued to meet temporary emergencies. In periods of tight money and high interest rates, or of general uncertainty over the industrial future, it is difficult to sell long-time bonds on favorable terms; hence it has been found expedient to sell short-term notes which can be refunded into long-term bonds at a more propitious time. Short-term notes are also used—and increasingly so—to provide funds for new construction under conditions such that the debt can be paid off out of earnings within a relatively short period of time. Their claim on income is secondary to that of bonds.

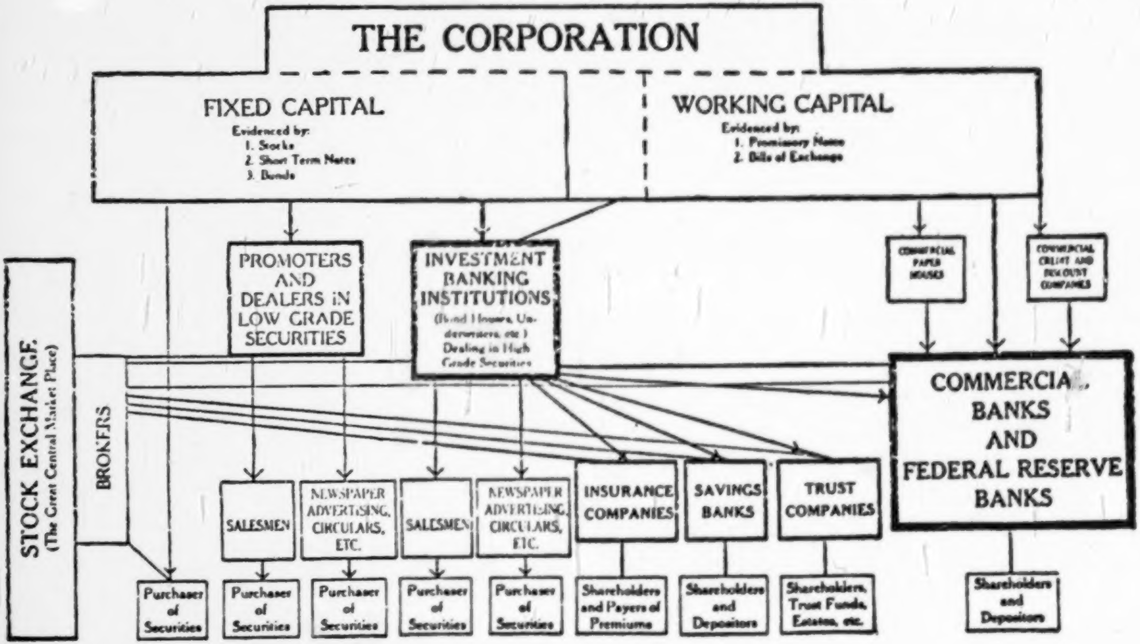
The accompanying illustrations are examples of a standard bond and a share of stock.

II. COMMERCIAL CREDIT INSTRUMENTS

Commercial credit instruments—promissory notes and bills of exchange—are the written evidences of the commercial borrowing operations discussed in the preceding chapter. Because of the nature of the uses to which funds borrowed for working-capital purposes are devoted, these instruments run for short periods of time only. Especial importance is attached to them because of the prevalent use of certain forms of bills of exchange as substitutes for money, a phenomenon made possible, as we shall see, by the principle of negotiability.

Book accounts.—Many credit operations are evidenced merely by entries in the account books of business men—"accounts receivable" in the books of the seller (or lender), and "accounts payable" in the books of the buyer (or borrower). While such informal credit extension is quite as significant as

II. INSTITUTIONS UTILIZED IN FINANCING CORPORATE ENTERPRISE



APPENDIX B

$150,000,000

CITICORP

16.45% Notes Due November 1, 1986

Price 100%

plus accrued interest, if any, from November 9, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

The First Boston Corporation

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

Salomon Brothers Inc

Warburg Paribas Becker
A. G. Becker

Morgan Stanley & Co. Incorporated	Bache Halsey Stuart Shields Incorporated	Bear, Stearns & Co.	Blyth Eastman Paine Webber Incorporated
Dillon, Read & Co. Inc.	Donaldson, Lufkin & Jenrette Securities Corporation		Drexel Burnham Lambert Incorporated
E. F. Hutton & Company Inc.	Keefe, Bruyette & Woods, Inc.	Kidder, Peabody & Co. Incorporated	Lazard Frères & Co.
Lehman Brothers Kuhn Loeb Incorporated	L. F. Rothschild, Unterberg, Towbin		Shearson/American Express Inc.
Smith Barney, Harris Upham & Co. Incorporated	Wertheim & Co., Inc.		Dean Witter Reynolds Inc.
Bateman Eichler, Hill Richards Incorporated	William Blair & Company	Blunt Ellis & Loewi Incorporated	J. C. Bradford & Co.
Alex. Brown & Sons	Dain Bosworth Incorporated	A. G. Edwards & Sons, Inc.	Janney Montgomery Scott Inc.
Ladenburg, Thalmann & Co. Inc.	McDonald & Company	Moseley, Hallgarten, Estabrook & Weeden Inc.	
New Court Securities Corporation	The Ohio Company		Oppenheimer & Co., Inc.
Piper, Jaffray & Hopwood Incorporated	Prescott, Ball & Turben		Rauscher Pierce Refsnes, Inc.
The Robinson-Humphrey Company, Inc.	Rotan Mosle Inc.		Thomson McKinnon Securities Inc.
Tucker, Anthony & R. L. Day, Inc.			Wheat, First Securities, Inc.
American Securities Corporation	Sanford C. Bernstein & Co., Inc.		Burns Fry and Timmins Inc.
Butcher & Singer Inc.	The Chicago Corporation	Craigie Incorporated	First of Michigan Corporation
Freeman Securities Company, Inc.	Interstate Securities Corporation		Laidlaw Adams & Peck Inc.
Cyrus J. Lawrence Incorporated	Legg Mason Wood Walker Incorporated	Neuberger & Berman	Stone & Youngberg
Burton J. Vincent, Chesley & Co.			Wood Gundy Incorporated

November 2, 1981

Wall St. J., Nov. 2, 1981, at 41

$100,000,000

CATERPILLAR TRACTOR CO.

14¾% Notes, due November 1, 1988

Price 100%

plus accrued interest from November 1, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

Lehman Brothers Kuhn Loeb
Incorporated

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

The First Boston Corporation — Salomon Brothers Inc

Bache Halsey Stuart Shields Incorporated — Bear, Stearns & Co. — Blyth Eastman Paine Webber Incorporated

Dillon, Read & Co. Inc. — Donaldson, Lufkin & Jenrette Securities Corporation — Drexel Burnham Lambert Incorporated

E. F. Hutton & Company Inc. — Kidder, Peabody & Co. Incorporated — Lazard Frères & Co.

L. F. Rothschild, Unterberg, Towbin — Shearson/American Express Inc. — Smith Barney, Harris Upham & Co. Incorporated

Warburg Paribas Becker A. G. Becker — Wertheim & Co., Inc. — Dean Witter Reynolds Inc.

ABD Securities Corporation — Advest, Inc. — Arnhold and S. Bleichroeder, Inc.

Atlantic Capital Corporation — Basle Securities Corporation — Alex. Brown & Sons

F. Eberstadt & Co., Inc. — A. G. Edwards & Sons, Inc. — EuroPartners Securities Corporation

Robert Fleming Incorporated — Kleinwort, Benson Incorporated — Ladenburg, Thalmann & Co. Inc.

Moseley, Hallgarten, Estabrook & Weeden Inc. — New Court Securities Corporation — Oppenheimer & Co., Inc.

Piper, Jaffray & Hopwood Incorporated — Thomson McKinnon Securities Inc. — Tucker, Anthony & R. L. Day, Inc.

American Securities Corporation — Bacon, Whipple & Co. — Robert W. Baird & Co. Incorporated

Bateman Eichler, Hill Richards Incorporated — Sanford C. Bernstein & Co., Inc. — William Blair & Company

Blunt Ellis & Loewi Incorporated — Boettcher & Company — J. C. Bradford & Co. — Burns Fry and Timmins Inc.

Butcher & Singer Inc. — Dain Bosworth Incorporated — Daiwa Securities America Inc. — Dominion Securities Ames Inc.

Fahnestock & Co. — First of Michigan Corporation — First Southwest Company — Foster & Marshall Inc.

Greenshields & Co Inc — J. J. B. Hilliard, W. L. Lyons, Inc. — Howard, Weil, Labouisse, Friedrichs Incorporated

Interstate Securities Corporation — Investment Corporation of Virginia — Janney Montgomery Scott Inc.

Johnson, Lane, Space, Smith & Co., Inc. — Johnston, Lemon & Co. Incorporated — Josephthal & Co. Incorporated

Legg Mason Wood Walker Incorporated — McDonald & Company — Moore & Schley, Cameron & Co.

Neuberger & Berman — Newhard, Cook & Co. Incorporated — The Nikko Securities Co. International, Inc.

Nomura Securities International, Inc. — The Ohio Company — Parker/Hunter Incorporated — Prescott, Ball & Turben

Rauscher Pierce Refsnes, Inc. — The Robinson-Humphrey Company, Inc. — Rotan Mosle Inc.

Scherck, Stein & Franc, Inc. — Schneider, Bernet & Hickman, Inc. — Stephens Inc. — Stifel, Nicolaus & Company Incorporated

Sutro & Co. Incorporated — Underwood, Neuhaus & Co. Incorporated — Wedbush, Noble, Cooke, Inc.

Wheat, First Securities, Inc. — Wood Gundy Incorporated — Yamaichi International (America), Inc.

Craigie Incorporated — Daniels & Bell, Inc. — Elkins & Co. — Ferris & Company Incorporated

First Harlem Securities Corporation — Furman Selz Mager Dietz & Birney Incorporated — Gruntal & Co.

Herzfeld & Stern — Cyrus J. Lawrence Incorporated

November 9, 1981

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Wall St. J, Nov. 9, 1981, at 45

$50,000,000

Borg-Warner Acceptance Corporation

15¼% Notes due November 15, 1988

Price 99.60%

plus accrued interest from November 15, 1981

Upon request, a copy of the Prospectus describing these securities and the business of the Company may be obtained within any State from any Underwriter who may legally distribute it within such State. The securities are offered only by means of the Prospectus, and this announcement is neither an offer to sell nor a solicitation of any offer to buy.

Goldman, Sachs & Co.

The First Boston Corporation — Merrill Lynch White Weld Capital Markets Group (Merrill Lynch, Pierce, Fenner & Smith Incorporated) — Salomon Brothers Inc

Bache Halsey Stuart Shields Incorporated — Bear, Stearns & Co. — Blyth Eastman Paine Webber Incorporated — Dillon, Read & Co. Inc.

Donaldson, Lufkin & Jenrette Securities Corporation — Drexel Burnham Lambert Incorporated — E. F. Hutton & Company Inc.

Kidder, Peabody & Co. Incorporated — Lazard Frères & Co. — Lehman Brothers Kuhn Loeb Incorporated

L. F. Rothschild, Unterberg, Towbin — Shearson/American Express Inc. — Smith Barney, Harris Upham & Co. Incorporated

Warburg Paribas Becker A. G. Becker — Wertheim & Co., Inc. — Dean Witter Reynolds Inc.

ABD Securities Corporation — Advest, Inc. — Arnhold and S. Bleichroeder, Inc. — Atlantic Capital Corporation

Bacon, Whipple & Co. — Robert W. Baird & Co. Incorporated — Basle Securities Corporation — Bateman Eichler, Hill Richards Incorporated

William Blair & Company — Blunt Ellis & Loewi Incorporated — Boettcher & Company — J. C. Bradford & Co.

Alex. Brown & Sons — Dain Bosworth Incorporated — A. G. Edwards & Sons, Inc.

EuroPartners Securities Corporation — First Southwest Company — Robert Fleming Incorporated — Foster & Marshall Inc.

Janney Montgomery Scott Inc. — Kleinwort, Benson Incorporated — Ladenburg, Thalmann & Co. Inc.

McDonald & Company — Moseley, Hallgarten, Estabrook & Weeden Inc. — New Court Securities Corporation

The Ohio Company — Oppenheimer & Co., Inc. — Piper, Jaffray & Hopwood Incorporated — Prescott, Ball & Turben

Rauscher Pierce Refsnes, Inc. — The Robinson-Humphrey Company, Inc. — Rotan Mosle Inc. — Sutro & Co. Incorporated

Thomson McKinnon Securities Inc. — Tucker, Anthony & R. L. Day, Inc. — Wheat, First Securities, Inc.

Sanford C. Bernstein & Co., Inc. — Burns Fry and Timmins Inc. — Dominion Securities Ames Inc.

Greenshields & Co Inc — Neuberger & Berman — Wood Gundy Incorporated — Craigie Incorporated

November 12, 1981

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Wall St. J, Nov. 12, 1981, at 40

This announcement is under no circumstances to be construed as an offer to sell or as a solicitation of an offer to buy any of these securities.
The offering is made only by the Prospectus.

NEW ISSUE

November 23, 1981

$75,000,000

Credithrift Financial Corporation

15½% Senior Notes due December 1, 1991

Price 100%

(Plus accrued interest from December 1, 1981)

Copies of the Prospectus may be obtained in any State in which this announcement is circulated from only such of the undersigned or other dealers or brokers as may lawfully offer these securities in such State.

Merrill Lynch White Weld Capital Markets Group
Merrill Lynch, Pierce, Fenner & Smith Incorporated

The First Boston Corporation — **Goldman, Sachs & Co.** — **Salomon Brothers Inc** — **Bache Halsey Stuart Shields Incorporated**

Bear, Stearns & Co. — **Blyth Eastman Paine Webber Incorporated** — **Dillon, Read & Co. Inc.** — **Drexel Burnham Lambert Incorporated**

E. F. Hutton & Company Inc. — **Kidder, Peabody & Co. Incorporated** — **Lazard Frères & Co.**

L. F. Rothschild, Unterberg, Towbin — **Shearson/American Express Inc.** — **Smith Barney, Harris Upham & Co. Incorporated**

Warburg Paribas Becker A. G. Becker — **Wertheim & Co., Inc.** — **Dean Witter Reynolds Inc.**

Alex. Brown & Sons — **A. G. Edwards & Sons, Inc.** — **Thomson McKinnon Securities Inc.** — **Robert W. Baird & Co. Incorporated**

William Blair & Company — **Blunt Ellis & Loewi Incorporated** — **J. C. Bradford & Co.** — **Butcher & Singer Inc.** — **Dain Bosworth Incorporated**

Foster & Marshall Inc. — **Janney Montgomery Scott Inc.** — **Kleinwort, Benson Incorporated** — **McDonald & Company**

Moseley, Hallgarten, Estabrook & Weeden Inc. — **Nomura Securities International, Inc.** — **Piper, Jaffray & Hopwood Incorporated**

Prescott, Ball & Turben — **Rotan Mosle Inc.** — **Wheat, First Securities, Inc.**

American Securities Corporation — **Freeman Securities Company, Inc.** — **Herzfeld & Stern** — **Laidlaw Adams & Peck Inc.**

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Wall St. J., Nov. 23, 1981, at 39

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Securities.
The offer is made only by the Prospectus.

$400,000,000

E. I. du Pont de Nemours and Company

14% Notes Due 1991

Interest payable June 1 and December 1

Price 100% and Accrued Interest

Copies of the Prospectus may be obtained in any State from only such of the undersigned as may legally offer these Securities in compliance with the securities laws of such State.

MORGAN STANLEY & CO. — THE FIRST BOSTON CORPORATION

GOLDMAN, SACHS & CO. — MERRILL LYNCH WHITE WELD CAPITAL MARKETS GROUP — SALOMON BROTHERS INC

BACHE HALSEY STUART SHIELDS — BEAR, STEARNS & CO. — BLYTH EASTMAN PAINE WEBBER

DILLON, READ & CO. INC. — DONALDSON, LUFKIN & JENRETTE — DREXEL BURNHAM LAMBERT

E. F. HUTTON & COMPANY INC. — KIDDER, PEABODY & CO. — LAZARD FRERES & CO.

LEHMAN BROTHERS KUHN LOEB — L. F. ROTHSCHILD, UNTERBERG, TOWBIN

SHEARSON/AMERICAN EXPRESS INC. — SMITH BARNEY, HARRIS UPHAM & CO.

WARBURG PARIBAS BECKER — WERTHEIM & CO., INC. — DEAN WITTER REYNOLDS INC.

ATLANTIC CAPITAL — BASLE SECURITIES CORPORATION — ALEX. BROWN & SONS

MOSELEY, HALLGARTEN, ESTABROOK & WEEDEN INC. — OPPENHEIMER & CO., INC.

THOMSON McKINNON SECURITIES INC. — TUCKER, ANTHONY & R. L. DAY, INC. — ADVEST, INC.

ARNHOLD AND S. BLEICHROEDER, INC. — SANFORD C. BERNSTEIN & CO., INC.

BURNS FRY AND TIMMINS INC. — DAIWA SECURITIES AMERICA INC. — DOMINION SECURITIES AMES INC.

ROBERT FLEMING — JANNEY MONTGOMERY SCOTT INC. — LADENBURG, THALMANN & CO. INC.

THE NIKKO SECURITIES CO. — NOMURA SECURITIES INTERNATIONAL, INC.

WOOD GUNDY INCORPORATED — YAMAICHI INTERNATIONAL (AMERICA), INC.

November 23, 1981

Wall St. J., Nov. 23, 1981, at 42

No. 82-1766-CFX
Status: GRANTED

Title: Securities Industry Association, et al., Petitioners
v.
Board of Governors of the Federal Reserve System, et al.

Docketed:
April 29, 1983

Court: United States Court of Appeals for the District of Columbia Circuit

Counsel for petitioner: Weidner, James B., Pitt, Harvey L.

Counsel for respondent: Bradfield, Michael, Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Apr 29 1983	G	Petition for writ of certiorari filed.
2	Apr 29 1983		Appendix of petitioner Securities Industry Assn. filed.
5	May 25 1983		Order extending time to file response to petition until June 30, 1983.
6	Jun 30 1983		Brief amicus curiae of Bankers Trust Company filed.
7	Jun 30 1983		Order further extending time to file response to petition until July 21, 1983.
8	Jul 22 1983		Brief of respondents in opposition filed.
9	Jul 27 1983		DISTRIBUTED. September 26, 1983
11	Aug 12 1983	X	Reply brief of petitioner Securities Industry Assn. filed.
12	Oct 3 1983		Petition GRANTED.
			**
13	Oct 13 1983		Record filed.
14	Oct 13 1983		Certified original record & proceedings received (3 Boxes)
15	Nov 16 1983		Joint appendix filed.
16	Nov 17 1983		Brief of petitioner A. G. Becker, Inc. filed.
17	Nov 17 1983		Brief amicus curiae of Investment Company Institute filed.
18	Nov 17 1983		Brief of petitioner Securities Industry Assn. filed.
19	Nov 17 1983		Brief amicus curiae of Goldman, Sachs & Co. filed.
20	Dec 2 1983	D	Motion of petitioners for divided argument filed.
21	Dec 12 1983		Motion of petitioners for divided argument DENIED. Justice Marshall would grant this motion.
23	Dec 21 1983		Order extending time to file brief of respondent on the merits until January 9, 1984.
24	Jan 6 1984		Order further extending time to file brief of respondent on the merits until January 13, 1984.
25	Jan 13 1984		Brief of respondents Bd. of Governors, et al. filed.
26	Jan 13 1984		Brief amicus curiae of New York Clearinghouse Assn., et al. filed.
27	Jan 13 1984		Brief amicus curiae of Bankers Trust Company filed.
28	Feb 14 1984		SET FOR ARGUMENT. Wednesday, March 21, 1984. (2nd case)
29	Feb 15 1984		CIRCULATED.
30	Mar 13 1984	X	Reply brief of petitioner Securities Industry Assn. filed.
31	Mar 14 1984	X	Reply brief of petitioner A. G. Becker, Inc. filed.
32	Mar 21 1984		ARGUED.